United States Court of Appeals

for the

District of Columbia Circuit

TRANSCRIPT OF RECORD

396

JOINT APPENDIX

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

TEXAS INTERNATIONAL AIRLINES, INC., Petitioner	:	
v.	:	No. 24,459
CIVIL AERONAUTICS BOARD, Respondent	:	

On Petition for Review of an Order of the Civil Aeronautics Board

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UNITED STATES OF AMERICA
CIVIL AERONAUTICS BOARD
WASHINGTON, D. C.

Order 69-1-99

Issued under delegated authority
January 24, 1969

LOCAL SERVICE CLASS SUBSIDY RATE (FRONTIER AIRLINES, INC. SUBSIDY REFUND - 1964, 1965 and 1966)	Dockets 15359 and 16750

ORDER DETERMINING SUBSIDY REFUND

In this order the Board has determined, pursuant to the provisions of Class Rates III 1/ and III-A, 2/ that Frontier Airlines, Inc., shall refund $1,009,808 of subsidy for the calendar year 1964, $1,524,181 for the calendar year 1965, and $787,195 for the calendar year 1966. Since $1,865,604 has already been withheld by the Board, the net refund required will be $1,455,580 for the three year period.

The history, background, and general nature of class rate profit-sharing determinations have been thoroughly canvassed and explained in numerous Board orders determining subsidy refunds for local service carriers. 3/ For present purposes, it is sufficient to state that Class Rates III and III-A, like most of the other class rates, 4/ under certain conditions require refunds of a portion of the subsidy paid; that the refunds are to be made in accordance with the detailed profit-sharing provisions of the rate formula; and that a special report, Form T-88, must be submitted by each local service carrier in order to facilitate the profit-sharing and subsidy refund calculations. The administration of profit-sharing and subsidy refunds does not involve rate-making determinations and the profit-sharing provisions of the Class Rate III and III-A formulas are final, are not open to contest retroactively, and are not in issue.

1/ 41 C.A.B. 138, 139 (1964).
2/ Orders E-23697, May 18, 1966, and E-23850, June 23, 1966.
3/ See, e.g., Frontier Airlines, Inc., Subsidy Refund - 1963, Order E-24109, August 22, 1966.
4/ Under Class Rate IV, Orders E-25162, May 17, 1967, and E-25231, June 1, 1967, a revenue-growth reduction factor has replaced the profit-sharing provisions of prior Class Rates.

On April 19, 1965, April 18, 1966, and April 14, 1967, Frontier submitted Forms T-88 in connection with the determination of profit-sharing for 1964, 1965, and 1966, respectively. In accordance with established practice, the Forms T-88 have been subjected to field audit by the Board's staff at the site of the carrier's operations and staff reports of the audit findings have been made to the Board. Upon review of the audit reports, the carrier's Form 41 reports, the data contained in the carrier's T-88 reports, and the supplemental materials developed in communications and discussions between Frontier and the Board's staff, the Board has concluded that under the terms of Class Rate III Frontier shall refund $1,009,808 of subsidy for calendar year 1964, and $1,524,181 of subsidy for calendar year 1965, and under the terms of Class Rate III-A Frontier shall refund $787,195 of subsidy for calendar year 1966. 5/

The Forms T-88 submitted by the carrier conform to, and are consistent with, the requirements of the class rate, except in the following respects:

1964 Adjustments

* * *

(page 4)

8. Pursuant to section III E we have adjusted the income taxes shown on the carrier's T-88 to reflect the impact of loss carrybacks to 1964 from 1967. As a result, income taxes included by the carrier have been reduced $910,287 and average investment increased $81,824 to reflect the reduced tax liability.

* * *

(page 6)

1965 Adjustments

* * *

6. Pursuant to section III E, the Board has recognized income taxes based on the carrier's income tax returns, as filed, adjusted to include a refund of $283,927 related to the carryback of net operating losses sustained by the carrier in 1967. Income taxes reported by the carrier on its Form T-88 were adjusted by reductions of (a) $16,380 applicable to flight equipment capital gains excluded from revenues, (b) $3,082, to reflect proper allowances for taxes related to profit-sharing for 1962, (c) $14,401, to restore a tax credit related to unused vacation expense reported in the carrier's tax returns, since the credit was improperly excluded by the carrier in its Form T-88, (d) $43,100, related to Internal Revenue Service audits for prior years, (e) $1,102, to eliminate the carrier's adjustment for a State tax deficiency for a prior period, since the deficiency was offset by a carryback of tax losses, and (f) $13,375, to exclude the carrier's claim for a 1962 investment tax credit which had been restored to the carrier in an earlier order of the Board. In addition, we are increasing taxes by $3,178 in order properly to reflect State income taxes for 1965. Appropriate adjustments also have been made to reflect the foregoing in investment.

* * *

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1966 Adjustments

1. Section III B 1 of Class Rate III-A requires that expenses reported for profit-sharing purposes be consistent with the reporting requirements of the Act and the Board's accounting regulations. In our profit-sharing determination for 1964 (item 2) we reduced the carrier's claimed expenses for that year by $60,000 which had been received as insurance premium refunds but which the carrier had not recorded as a reduction of insurance expense. However, in October 1966 the carrier recorded these refunds as a credit to expense. To prevent duplication of the 1964 disallowance we are, therefore, increasing 1966 expenses by $60,000 and we are making an appropriate adjustment to investment.

2. In accordance with section III B 3 c, which prohibits recognition of costs related to financing, we have disallowed $7,736 of expenses incurred in connection with the issuance of stock dividends.

3. Pursuant to section III B 3 h, $1,620 of non-recognizable dues have been eliminated.

4. Various adjustments have been made pursuant to section III B 4 to reflect the correct amortization of developmental and preoperating expenses, resulting in a net disallowance of $1,444 from the carrier's claim.

5. Consistent with our profit-sharing determination for 1964 (item 7), several adjustments have been made to the carrier's accounting related to the conversion of Convair 340 aircraft to Convair 580 aircraft. Pursuant to sections III B 1, III B 7, III C 1, and III C 2 1 of the class rate and to the Board's regulations governing flight equipment investment and depreciation, we are disallowing $15,709 of Convair 340 depreciation expense and an average of $853,730 of annual debt investment. In addition, we are reducing average equity investment by $123,723 to eliminate the carrier's inclusion of redundant CV-340 parts in the CV-580 investment and we are reducing depreciation by $448 related to this over-capitalization.

6. Pursuant to section III D, we have included as income for profit-sharing purposes $4,404 of flight equipment capital gains which were not reinvested in accordance with section 406(d) of the Act and the Board's regulations. In addition, the carrier correctly excluded from its T-88 non-operating expenses capital losses on the sale of flight equipment. However, the exclusion was understated by $1,510 due to the manner in which the carrier accounted for certain expenses incidental to the sale. Accordingly, we have increased net non-operating income by the $1,510.

7. In accordance with the requirements of section III E we have adjusted 1966 income taxes as reported by Frontier on its Form T-88 by making reductions of (a) $34,836, in order properly to reflect the taxes reported on the carrier's final tax returns, (b) $9,887, to correct an overstatement of taxes applicable to the difference between gross formula subsidy and subsidy reported on the carrier's tax returns, (c) $3,104, to reflect proper allowances for additional assessments of state income taxes for prior years, and (d) $24,809, to restore a tax credit related to unused vacation expense reported in the carrier's tax returns, since the credit was improperly excluded by the carrier in its T-88 reports.

8. Pursuant to section III F, we have made appropriate adjustments to the carrier's Form T-88 investment to reflect the various expense adjustments set forth above. In addition, the following adjustments to investment have been made:

(a) In 1966 the carrier allocated certain advertising costs to the first three calendar quarters on the basis of estimated revenue passenger miles, rather than upon the basis of services actually received. The carrier's method deferred expenses within the year so that average investment for the year was inflated by $66,784. Consistent with similar rulings in our profit-sharing determinations for earlier years, we have reduced investment by that amount.

(b) Section III C 1 requires that the investment reported for profit-sharing purposes be consistent with the reporting requirements of the Act and the Board's regulations. Pursuant to this section, equity investment in the last two quarters of 1966 has been reduced by $7,801 to correct the carrier's overcapitalization of interest on funds related to a B-727 aircraft placed in revenue service on September 30, 1966.

(c) Section III C 2 b requires the exclusion of non-operating property from investment. Pursuant to this section we have increased investment in the last quarter of 1966 by $13,376 to correct the carrier's showing the original cost instead of depreciated cost of nonoperating property in its adjustment to investment, and we have decreased average investment by $57,974 to correct the misclassification of certain B-727 and CV-340 spare parts inventories in operating rather than nonoperating accounts when the related aircraft types were not in revenue service.

(d) Pursuant to section III C 2 c, we have disallowed the carrier's average investment of $688 in nontransport activities.

(e) Under section III C 2 d, which prohibits the inclusion of the value of any life insurance policy purchased by the carrier, average investment is reduced by $14,660 representing prepaid insurance premiums.

(f) Section III C 2 f provides that funds restricted as to general availability shall not be included in investment. Pursuant to this section we have eliminated $48,000 from investment for the last two quarters of 1966 since the use of the proceeds from the sale of two DC-3 aircraft was restricted under the terms of a mortgage agreement.

Also pursuant to this section, we have eliminated from average investment $196,069, consisting of equipment purchase deposits, cash advances for construction of the carrier's operations base at Denver, and cash advances for airport improvements at Grand Junction. In addition, section III C 2 f does not recognize unamortized discount and expense on debt, and we have excluded $18,151 of such expenses recorded as a deferred charge in the last quarter of 1966.

(g) Various adjustments have been made to investment to reflect the correct amortization of developmental and preoperating costs. These adjustments result in net decreases in average investment of $32,733.

(h) Average investment has been decreased by $47,644 to reflect the proper impact on investment of the carrier's actual tax liability for 1966 and has been increased by $927,826 to reflect recovery of 1964 and 1965 taxes.

(i) A downward adjustment of $1,147,139 has been made to reflect the impact of profit-sharing refunds for the years 1963, 1964, and 1965, after the carrier's provisions for profit-sharing and net of taxes. Average investment has been increased by $2,557 to eliminate the carrier's understatement of the difference between gross subsidy payable for 1966 under the rate formula and the subsidy reported on the carrier's Form 41, both net of related taxes. Adjustments have also been made to reflect the impact on investment and taxes of the profit-sharing refund determination herein

With the revisions indicated above 9/ and after reflecting the impact of such revisions in the related calculations under the formula, the amount of subsidy refund due from Frontier Airlines, Inc., for the calendar year 1966 is determined to be $787,195.

Accordingly, pursuant to the authority duly delegated by the Board in its Organization Regulations, 14 CFR 385.16(a),

IT IS ORDERED That Frontier Airlines, Inc., shall refund to the Government, pursuant to the provisions of Class Rates III and III-A, $1,009,808 for the calendar year 1964, $1,524,181 for the calendar year 1965, and $787,195 for the calendar year 1966.

9/ See note 7/, supra.

Persons entitled to petition the Board for review of this order pursuant to the Board's Regulations, 14 CFR 385.50, may file such petitions within ten days after the date of service of this order.

This order shall be effective and become the action of the Civil Aeronautics Board upon expiration of the above period unless within such period a petition for review thereof shall have been filed, or the Board gives notice that it will review this order on its own motion.

By Harry H. Schneider
Chief, Local Service Division
Bureau of Economics

HAROLD R. SANDERSON

Secretary

(SEAL)

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70-3-92

UNITED STATES OF AMERICA
CIVIL AERONAUTICS BOARD
WASHINGTON, D. C.

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DOCKETS 15359 and 16750

LOCAL SERVICE CLASS SUBSIDY RATE
SUBSIDY REFUNDS:

Allegheny Airlines	- 1965-6
Lake Central	- 1965
Ozark	- 1966
Pacific	- 1964-5
Texas International	- 1966
West Coast	- 1965-6

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Decided: March 18, 1970

Tax allowances for purposes of computing profit-sharing under Class Rates III and III-A for years 1964-6 should reflect the effect of credits relating to operating losses incurred under Class Rate IV in 1967-9 which were carried back for tax purposes to 1964-6.

The amount of the credits actually realized by the carriers resulting from operating loss carrybacks should not be increased to reflect capital gains realized under Class Rate IV.

OPINION

BY THE BOARD:

The captioned proceedings involve the determination of the proper amounts owed to the government for the years 1964-1966 by the subject carriers under the profit-sharing provisions of Class Rates III [1/] and III-A. [2/] Common to all of the cases are certain issues relating to the treatment of loss carryback tax credits generated by operations in 1967, 1968, and 1969. The broad question presented is whether or not the applicable provisions of the class rate orders require that these credits be taken into account in determining the amount of tax allowance for profit-sharing purposes in 1964-66.

Because of the importance of the issues raised, the Board afforded the carriers an opportunity to present their views on the issues in writing to the Board. In addition, representatives of the carriers made an oral presentation to the Board. The Board, having considered all matters presented to it, has made its determinations as to the proper treatment of the items in question and in the interest of the orderly processing of the individual profit-sharing cases, has determined to issue this order embodying its decision and the reasons therefor at this time.

I.

From the inception of the local service class rate in 1961, [3/] and through calendar year 1966, each local service class rate contained two basic elements: a formula providing for the payment of gross subsidy in

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1/ 41 C.A.B. 138, 139 (1964).
2/ Orders E-23697, May 18, 1966, and E-23850, June 23, 1966.
3/ By Order E-16173, December 23, 1960, the Board instituted a proceeding directed to the establishment of a local service class subsidy rate. Class Rate I was established in 34 C.A.B. 416, 418 (1961).

which the amount of gross subsidy varied with the carrier's volume of operations and other factors as specified in the formula; and a profit-sharing provision under which the carrier refunded a portion of the gross subsidy payment if its actual return on investment exceeded a defined level. 4/ Effective January 1, 1967, the Board established Class Rate IV, 5/ which, with certain modifications not here pertinent, is still in effect. Class Rate IV eliminated profit-sharing, and substituted a revenue growth-sharing formula under which the gross subsidy was reduced by a percentage of the annual growth in the carrier's gross passenger revenues. Under the revenue growth adjustment, subsidy is reduced irrespective of the over-all net profit position of the carriers.

We are here concerned solely with profit-sharing under Class Rates III and III-A for the years 1964 through 1966. However, the issue presented involves the treatment of certain operating losses realized, or to be realized, by the carriers in the years 1967 through 1969 while they were operating under Class Rate IV. These losses are carried back under the

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4/ In general, the recognized rate of return for each carrier is determined by applying the specified percentage rates to the carrier's debt and equity components, subject to certain minimum and maximum over-all rates of return. The provisions require a refund to the Board of 50% of the profit between the recognized rate of return and the return of 15% on investment and 75% of profits in excess of a return of 15% on investment.

5/ Orders E-25162, May 17, 1967, and E-25231, June 1, 1967.

internal revenue laws to 1964 through 1966, thus reducing or eliminating the carriers' taxes in those years. The position of the Board's staff is that the resulting tax credits should be taken into account to reduce the allowance for the carriers' taxes to that shown on the carriers' actual income tax returns filed as amended for the years 1964 through 1966, whereas the carriers contend that they should be allowed to retain the benefit of the tax credits as an amelioration of the losses incurred under Class Rate IV. We find that we are in agreement with the staff on this basic question for the reasons set forth below.

II.

The class rate orders contain detailed provisions as to how revenues, expenses, investment, and income taxes shall be calculated for purposes of determining the amount of profit to be refunded to the Government. The provision regarding income taxes is set forth in section III-E, and so far as pertinent reads as follows:

> "1. Federal and State income taxes shall be determined on the basis of the carrier's actual income taxes, including the reduction of taxes resulting from loss carrybacks and carryovers and from investment tax credits, as reported on its income tax returns submitted to taxing authorities for each year, with such amendments and revisions as may have been filed as of the final determination of profit-sharing hereunder * * *" 6/ (Emphasis added.)

This provision is clear and unambiguous. On its face, it requires that any losses carried forward from earlier years or carried back from later years,

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6/ 41 C.A.B. 138, 169 (1964); Order E-23850, June 23, 1966, page 22..

which reduce the actual income taxes paid for the profit-sharing year under review, must, for profit-sharing purposes, be used to reduce the carrier's tax allowance for that year.

We do not understand that there is any dispute as to the literal meaning of section III-E. It is argued, however, that section III-E was in effect modified by the adoption of Class Rate IV with the result that loss carryback credits generated under Class Rate IV may not be utilized by the Board in reducing the tax allowances for profit-sharing purposes for the years to which Class Rates III and III-A are applicable. We find the argument unpersuasive.

To begin with, it must be emphasized that nothing in Class Rate IV dealt with the question of loss carryback credits. There is not the slightest suggestion in that order to support the contention that the Board intended to repeal or modify any part of the profit-sharing provisions of Class Rates III and III-A. Therefore, the argument that Class Rate IV amended Class Rates III and III-A must necessarily rest on the proposition that the substitution of the revenue growth formula for the profit-sharing formula is so inconsistent with the continued applicability of the loss carryback tax provisions of Class Rates III and III-A as to have effected a pro tanto repeal. That proposition cannot be established.

The carriers variously argue that had the Board not substituted the revenue growth adjustment in Class Rate IV for profit-sharing, the losses incurred under Class Rate IV would have been substantially reduced, because in the absence of excess profits there would have been no profit-sharing refund to the Government. Since the refund under the revenue growth

adjustment does not depend upon the profit status of the carrier, it is argued that carriers who incurred losses under Class Rate IV are penalized twice: once by having to refund a portion of their revenue growth to the government, and second by having the tax credits related to their losses applied to reduce prior subsidy rather than to ameliorate the losses. The argument boils down to the claim that, having sustained losses which were not underwritten by subsidy under Class Rate IV, the carriers are entitled to retain the benefit of the tax credits which those losses generated.

The surface plausibility of the argument does not in our judgment withstand close scrutiny. The short of the matter is that the position of the carriers is at war with the Board's actual tax policy as it has been administered for almost 20 years. We find nothing in the adoption of Class Rate IV which would lend any solid measure of support to the contention that we intended to modify this policy of long-standing, or indeed that it would have been sound for us to do so, and we conclude that no such modification occurred.

Since the decision in the Western Inland Mail Rate Case[7/] in 1951, the Board has adhered to the policy that the determination of tax allowances for purposes of subsidy under section 406(b) of the Act should be based on the carrier's actual income taxes as reflected on its tax returns filed with the Internal Revenue Service. The Board was there met with the contention of the carriers that taxes should be constructed on the assumption that the

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7/ 14 C.A.B. 243 (1951).

net taxable income for tax purposes was identical to the profit for return purposes (except for the tax reduction for return on indebtedness). As here, the carriers argued that the actual tax method "punished" them twice: once through disallowance of expenses incurred but not recognizable for rate-making purposes, and secondly by depriving them of the benefits of the tax deductions which the tax law allows. In the Board's view, however, calculating the carrier's taxes without regard to deductions and credits actually realized would result in paying to the carrier greater tax allowances than it actually incurred, and the Board considered "such allowances gratuities which we can no longer tolerate." 7a/ Rather, the Board emphasized that the function of the allowance for Federal income taxes is simply to insure that the carrier receives compensation for its income taxes as a cost of doing business. The allowance "is not designed to guarantee that the carrier will receive a gratuity or bonus which it can use to offset other losses. An allowance greater than the actual tax liability affords such a gratuity and should be avoided if possible." 8/ Thus, the carriers' basic contention here, that they should be permitted to retain the benefit of the tax credits as a cushion for losses incurred but not underwritten by the Board, was specifically rejected in the Western case.

On the basis of the above policy, no tax allowance was in fact made for Western in the Western Mail Rate Case because, as a result of loss carry-back credits, the carrier had no tax liability for the entire four-year

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7a/ 14 C.A.B. at 253.
8/ Ibid., at 252.

period under review in that case. While the tax loss carrybacks in that particular case were related to losses incurred during the open rate period, the principle established was clearly applicable whenever loss carryforwards or carrybacks reduce the actual income tax liability for any year under review, and the Board has ever since reduced the tax allowances by the amounts of credits actually utilized by the carrier on its income tax returns for open rate periods irrespective of the fact that its credits may have related to losses incurred in closed rate periods.[9/] And when the Board came to prescribing the method of computed tax allowances for purposes of profit-sharing under the class rate, it specifically incorporated this established policy that the allowable taxes shall not exceed the actual taxes as reflected in the carrier's returns, including loss carrybacks and carryforwards. It would take a far more persuasive showing than that before us to convince us that we unwittingly abandoned this policy with Class Rate IV.[10/]

Accordingly, we conclude that section III-E requires the reflection of loss carryback credits which the carrier has used on returns filed with the Internal Revenue Service to reduce its taxes for the profit-sharing years under review.

9/ See, e.g., Ozark Air Lines, Inc., Mail Rates, 32 C.A.B. 470, 474 (1960); Alaska Coastal-Ellis Airlines, Mail Rates, 40 C.A.B. 371, 376, 377, 379 (1964); Alaska Airlines, Inc., Mail Rates, 24 C.A.B. 273, 278 (1956); Trans-Pacific Airlines, Ltd., Mail Rates, 14 C.A.B. 273, 279 (1951).

10/ The argument that the Board is legally barred from reaching losses generated under Class Rate IV because Class Rate IV is an independent and final rate is without merit. The allowances for taxes are clearly and unambiguously set forth in Class Rates III and III-A, which were in effect for the periods under review. Indeed, the converse of the carriers' argument would appear to be more accurate, namely that failure to reflect the carrier's actual income taxes, including these carryback credits, would involve a retroactive amendment to the class rate order which is barred by the principle of Transcontinental & Western Air Lines, Inc. v. C.A.B., 336 U.S. 601 (1949).

III.

The foregoing determination disposes of the broad issue as it affects the tax loss carrybacks from 1967 and 1968. However, a separate issue is raised with respect to 1969. The carriers' tax returns for the calendar year 1969 are due under the tax laws on March 15, 1970. However, the carriers have advised us that they will seek permission from the Internal Revenue Service to file their returns late, which is alleged to be consistent with their past practice. Thus, as of the date of the issuance of this order, it does not appear that the carriers have in fact filed their income tax returns covering 1969, and consequently have not reflected any loss carryback credits from 1969 against taxes paid for 1966, a profit-sharing year. Nevertheless, it appears from the air carriers' financial reports filed with the Board, and the carriers themselves acknowledge, that they will in fact have significant loss carrybacks related to the 1969 tax year which will be available to reduce or totally eliminate their tax liabilities for 1966. Notwithstanding the foregoing, the carriers urge that the computation of the tax allowance for profit-sharing purposes should not take into account these credits. The carriers argue that however we may dispose of the issue as it relates to 1967 and 1968 credits, 1969 stands on a different footing. They point to the fact that section III-E-1 specifically provides that the tax allowances shall be based upon the "tax returns submitted to taxing authorities for each year, with such amendments and revisions as may have been filed as of the final determination of profit-sharing hereunder . . ." It is thus

contended that a literal application of the foregoing provision would not support the reduction of tax allowances on the basis of credits anticipated but not embodied in filed tax returns.

But to accept such an argument is to ignore reality at the expense of the U.S. Treasury. Under the quoted provision, as well as under our administrative practice, the Board takes the tax returns as it finds them, and does not attempt to project taxes as they may appear on returns to be filed in the future. Here, however, the fact that the carriers will realize substantial tax credits is no longer a matter of forecast. Their Form 41 reports for the calendar year 1969 have been filed and disclose that such credits will in fact be claimed. The carriers do not dispute this. Moreover, had the carriers filed their returns on March 15, as provided by statute, section III-E-1 would require us to take into account the credits. The Board cannot in good conscience permit the tax allowance to be affected by a matter so wholly within the control of the carriers as a request for an extension to file their income tax returns. We do not, of course, mean to question the carriers' motives in seeking an extension of time from Internal Revenue Service. But by the same token, the grant of such an extension cannot be accepted as the basis for a tax allowance which is patently in excess of the carriers' actual taxes. In view of the foregoing, the Board has determined to finalize profit-sharing for the year 1966 on the basis of either a pro forma tax return for 1969, or a copy of the actual return as filed with Internal Revenue Service.

IV.

In reaching the foregoing determinations, we have considered the carriers' arguments that they are being subjected to discrimination because, in some instances, other local service carriers had their profit-sharing for these years established prior to the filing of their tax returns embodying loss carryback credits, and tax allowances for profit-sharing purposes therefore did not take these credits into account. Since these determinations have been considered to be final, these carriers have in effect retained the benefit of the credits. The carriers' argument is similar to arguments based on administrative lag which the Board has considered and rejected. 11/

The Board is here applying a policy it has consistently applied to all carriers similarly situated. That policy is to predicate the tax allowances on the basis of the carrier's actual income tax liability so far as it is known at the time of the Board determination. The Board has always been aware of the fact that in the normal course of administration of tax laws, the carrier's taxes for a given year are subject to change after our determination has been made final. But it would be totally infeasible to attempt to hold open each case until all possibility of amendment to the carrier's tax returns for that year had passed. Taxes can be affected by carryback credits, by voluntary amendments of returns by the taxpayer, and by deficiency assessment of the Internal Revenue

11/ National Airlines, Inc., Mail Rates, 18 C.A.B. 442 (1954).

Service, and were we to defer our final action on return and profit-sharing matters until the various statutory limitation periods expired, it would be virtually impossible to maintain carriers on a current rate status and there would be continual uncertainty as to the government's obligations under section 406, as well as uncertainty as to the carrier's revenues. It is for these reasons that the Board has followed the practice of relying upon the tax returns on file as of the date of finalization of the rate or profit-sharing case. In this manner, both the carrier and the Board are bound to the facts then existing. Subsequent changes in the tax allowance may work to the carrier's benefit or to its detriment, and the carrier takes the risk that a subsequent deficiency assessment by Internal Revenue Service will occur in a closed rate period and will not be underwritten under section 406. By the same token, tax refunds for the year become beyond our reach if they occur during a closed rate period.

The fact that some carriers' profit-sharing determinations were made final while the present carriers' cases were still pending provides no basis for departing from our actual tax policy and the tax provisions of the class rate orders. There is no claim that the Board or its staff has acted in an arbitrary fashion in the order in which the cases have been processed, and the Board has in fact attempted to process all of these cases as expeditiously as possible consistent with its workload and resources. Nevertheless, some cases must be processed before others, and if in this particular instance some carriers have benefited from the fact that their cases were completed more promptly than others, that

fact would not warrant us in providing an excessive tax allowance for the carriers whose cases are still before us.

V.

We finally turn to an issue raised by the staff as to the effect of certain capital gains realized in 1968 by Ozark and Texas International. These gains are protected under the terms of section 406(d) of the Act from offset against subsidy requirements.[12/] The staff contends that since the carriers are in effect permitted to keep these gains, they should be charged with the taxes related to them. Since the carriers' income tax returns for 1966 indirectly reflect these capital gains, in the sense that the gains reduced the amount of the loss carryback credit, the staff proposes an adjustment to the tax returns so as to remove the impact of the gains on allowable taxes. However, the adjustment proposed is not supported by the language of the class rate order.[13/] Moreover, the adjustment is in our opinion not consistent with the principle underlying the loss carryback provision, as well as with our affirmance herein of the policy that taxes shall be based upon actual taxes. Having determined

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12/ Section 406(d) provides in substance that capital gains realized upon a disposition of flight equipment shall not be considered in determining the need of the carrier for subsidy purposes if the gains are reinvested in other flight equipment.

13/ Section III-E-1 provides that "the carrier's actual income taxes for a given review year will be adjusted to exclude taxes related to income which is not otherwise considered in the profit-sharing determination, hereunder, for that review year . . ." Under this provision, capital gains taxes related to gains realized in a profit-sharing year would be excluded for purposes of the profit-sharing determination.

that the loss carryback credit should be reflected in the tax allowance notwithstanding the fact that the losses occurred in a closed rate period, it would be inconsistent for us not to take into account an offset to the credit which the carrier by law is required to make, on the ground that it relates to a gain which is not recognized for subsidy purposes.

Appropriate orders embodying the foregoing determinations will be entered following completion of the processing of the individual profit-sharing cases.[14/]

BROWNE, Chairman, GILLILLAND, Vice Chairman, MINETTI, MURPHY, and ADAMS, Members, concurred in the above opinion.

14/ Certain other issues raised by the carriers will be disposed of in the processing of their individual profit-sharing cases.

UNITED STATES OF AMERICA
CIVIL AERONAUTICS BOARD
WASHINGTON, D. C.

Adopted by the Civil Aeronautics Board
at its office in Washington, D. C.
on the 21st day of May, 1970

LOCAL SERVICE CLASS SUBSIDY RATE (TEXAS INTERNATIONAL AIRLINES, INC. SUBSIDY REFUND - 1966)	Dockets 16750 and 15359

ORDER DETERMINING SUBSIDY REFUND

In this order the Board has determined, pursuant to the provisions of Class Rate III-A, 1/ that Texas International Airlines, Inc., shall refund $296,792 of subsidy for the calendar year 1966.

The history, background, and general nature of class rate profit-sharing determinations have been thoroughly canvassed and explained in numerous Board orders determining subsidy refunds for local service carriers. 2/ For present purposes, it is sufficient to state that Class Rate III-A, like most of the other class rates, 3/ under certain conditions requires refunds of a portion of the subsidy paid; that the refunds are to be made in accordance with the detailed profit-sharing provisions of the rate formula; and that a special report, Form T-88, must be submitted by each local service carrier in order to facilitate the profit-sharing and subsidy refund calculations. The administration of profit-sharing and subsidy refunds does not involve rate-making determinations and the profit-sharing provisions of the Class Rate III-A formula are final, are not open to contest retroactively, and are not in issue.

1/ Orders E-23697, May 18, 1966, and E-23850, June 23, 1966.
2/ See e.g., Trans-Texas Airways, Inc., Subsidy Refund - 1964, Order E-25209, May 29, 1967.
3/ Under Class Rate IV, Orders E-25162, May 17, 1967, and E-25231, June 1, 1967, a revenue-growth adjustment reduction factor has replaced the profit-sharing provisions of prior class rates.

On April 19, 1967, Texas International submitted Form T-88 in connection with the determination of profit-sharing for 1966. In accordance with established practice, the Form T-88 has been subjected to field audit by the Board's staff at the site of the carrier's operations, and a staff report of the audit findings has been made to the Board. Upon review of the audit report, the carrier's Form 41 reports, the data contained in the carrier's T-88 report, and the supplemental materials developed in communications and discussions between Texas International and the Board's staff, we have concluded that under the terms of Class Rate III-A Texas International shall refund $296,792 of subsidy for calendar year 1966.

The Form T-88 submitted by the carrier for 1966 conforms to, and is consistent with, the requirements of the class rate, except in the following respects:

1. Several adjustments have been made to the carrier's accounting related to the conversion of Convair 240 aircraft to Convair 600 aircraft. After Texas International withdrew the CV-240's from service for conversion to the new aircraft type, the carrier did not reclassify the undepreciated cost of these aircraft to the "construction work in progress" account until the conversion to CV-600 aircraft had been completed. Instead, it left the remaining net book value of the CV-240 in the operating property accounts and continued to charge expense with CV-240 depreciation until the CV-600's were ready to enter service. Further, other conversion costs of two of the CV-600's (costs in addition to the net book value of the CV-240's used in construction of those aircraft) were recorded in flight equipment accounts prior to entry of those aircraft into transport service. Pursuant to sections III B 1, III B 7, III C 1, and III C 2 1 of the class rate and the Board's regulations governing flight equipment investment and depreciation, we are disallowing $13,311 of Convair 240 depreciation expense and an average of $265,471 of annual debt investment. Concomitant with the disallowance of CV-240 depreciation expense we have increased average equity investment by $6,365. In addition, we have decreased average debt investment by $11,068 to reflect the elimination of other costs capitalized in connection with the Convair conversion program, consisting of import duties, brokerage fees, transportation, and insurance, prior to entry of the CV-600 aircraft into useful service.

2. Pursuant to section III B 3 m, we have eliminated $7,500 of salary and other nonallowable expenses related to nontransport activities.

3. Various adjustments have been made pursuant to section III B 4 to reflect the correct amortization of developmental and preoperating costs, resulting in a net disallowance of $13,805.

4. Sections III B 7 and III B 9 set forth rules for depreciation of flight equipment and ground property and equipment for class rate purposes. Consistent with our 1965 adjustment (Order 68-11-15, item 7), we have increased depreciation expense by the net amount of $2,821 to reflect recognized depreciation on a group basis for DC-3 and CV-240 flight equipment. In addition, the computation of group depreciation for certain ground property and equipment has been adjusted to reflect a six-year life rather than the five-year life used by the carrier. In October 1966 the carrier booked a $25,284 downward adjustment to depreciation expense to reflect our audit finding that depreciation expense for 1965 had been overstated by that amount. However, since we had already adjusted depreciation expense in our 1965 profit-sharing order to correct the overstatement, in order to avoid duplication, we have restored the $25,284 to depreciation expense for 1966.

5. Section III D provides that no nonoperating expenses shall be recognized except capital losses on ground equipment. The carrier inadvertently excluded $979 of losses on ground equipment, and we are therefore decreasing net nonoperating income by that amount.

6. Consistent with our actual tax policy, as reaffirmed in Order 70-3-92, March 18, 1970, and in accordance with the requirements of section III E, we have adjusted federal income taxes for 1966, reported by Texas International on its Form T-88, to reflect the carryback of 1968 and 1969 net operating losses. As a result, no provision has been made for federal income taxes for 1966. We have provided for state income taxes as reported by Texas International on its state tax returns, adjusted (1) to correct a $246 understatement of taxes applicable to the difference between gross formula subsidy and subsidy reported on the carrier's tax returns, and (2) to eliminate $493 of taxes applicable to capital gains on flight equipment excluded from revenue.

7. Pursuant to section III F, the Board has made appropriate adjustments to the carrier's Form T-88 investment to reflect the various expense adjustments set forth above. In addition, the following adjustments to investment have been made.

a. Section III C 1 requires that investment be reported consistent with the requirements of the Act and with Board regulations.

On December 31, 1966, the carrier capitalized $38,377 of interest which had been expensed in 1965, and, in computing its T-88 investment, eliminated that amount from debt. However, the $38,377 should have been excluded from equity since it had originally been recorded on the carrier's books as an expense. In correcting the carrier's accounting, we have reduced average equity investment by $4,797 and restored the same amount to average debt investment.

Further, pursuant to section III C 1, we have reduced average investment by $1,399 to remove from investment for the June quarter an amount erroneously recorded as a profit on the sale of flight equipment spare parts in that quarter and subsequently eliminated from investment in the September quarter by a reversing entry.

b. Section III C 2 e provides that investment shall not include equipment replacement funds derived from the sale of flight equipment. Pursuant to that section, we have eliminated from average equity investment $25,886 of gains and from average investment on a pro rata basis $5,989 of proceeds, exclusive of gains, derived from the sale of flight equipment.

c. Pursuant to section III C 2 f we have excluded from investment on a pro rata basis an average of $393,750 of equipment purchase deposits erroneously classified by the carrier as receivables.

d. The carrier's capitalization and amortization of developmental and preoperating costs, as reported on its T-88, have been adjusted to amounts recognizable for the year, resulting in a decrease in average investment of $1,609.

e. Section III C 2 1 provides that debt investment shall be adjusted to exclude costs related to equipment prior to its entry into useful service. Pursuant to that section we are eliminating the cost of DC-9 flight equipment recorded on the carrier's books in the second and third quarters of 1966, and a $15,000 prepayment to the manufacturer for DC-9 equipment recorded at September 30, 1966, since the equipment was not placed in service until October 1966. As a result of these adjustments, average debt investment is reduced by $128,125.

f. Consistent with our adjustments to depreciation expense in items 1 and 4, above, and to reflect the impact on 1966 investment of our depreciation adjustments in the 1965 profit-sharing case (Order 68-11-15, item 7), we have increased average investment by $83,128.

g. Investment has been increased by an average $216,451 to reflect the impact of the actual tax liabilities for 1965 and 1966.

h. A downward average adjustment of $299,486 has been made to reflect the impact of profit-sharing refunds for the years 1962, 1963, 1964, and 1965 after the carrier's provisions for profit-sharing and net of taxes. Average investment has been increased $10,280 to correct an erroneous downward adjustment made by the carrier to reflect the difference between gross subsidy payable for 1966 under the rate formula and the subsidy reported on the carrier's Form 41, both net of related taxes. Adjustments have also been made to reflect the impact on investment and taxes of the profit-sharing refund determination herein.

With the revisions indicated above 4/ and after reflecting the impact of such revisions in the related calculations under the formula, the amount of subsidy refund due from Texas International Airlines, Inc., for the calendar year 1966 is determined to be $296,792.

ACCORDINGLY, IT IS ORDERED THAT: Texas International Airlines, Inc. shall refund $296,792 to the Government for the calendar year 1966 pursuant to Class Rate III-A.

By the Civil Aeronautics Board:

HARRY J. ZINK

Secretary

(SEAL)

4/ In addition to the revisions and adjustments discussed above, other minor adjustments of a miscellaneous and routine nature have been made, but none of them are of sufficient consequence either individually or collectively to warrant discussion herein.

CIVIL AERONAUTICS BOARD
Washington, D. C. 20428

REPORT OF EARNINGS SUBJECT TO PROFIT-SHARING PURSUANT TO THE PROVISIONS OF LOCAL SERVICE CLASS SUBSIDY RATE, DOCKETS 15359 and 16750, ORDERS E-21311 and 23850 AS AMENDED

Twelve months ended December 31, 19 66

Trans-Texas Airways, Inc.
(Full name of reporting company)

CERTIFICATION*

I, the undersigned Treasurer
(Title of officer in charge of accounts)

of the Trans-Texas Airways, Inc.
(Full name of the reporting company)

do certify that this report and all schedules and supporting documents which are submitted herewith or have been submitted heretofore as parts of this report filed for the above indicated period have been prepared under my direction; that I have carefully examined them and declare that they correctly reflect the accounts and records of the company, and to the best of my knowledge and belief are a complete and accurate statement of the earnings subject to profit-sharing for the period indicated above, computed in accordance with the provisions of Orders E-21311 and E-23850 as amended.

H. H. Farr (Signature)

(Post office address)

Date April 19, 1967

* Title 18 of the United States Code, 18 U.S.C., 1001, makes it a criminal offense subject to a maximum fine of $10,000 or imprisonment for not more than 5 years, or both, to knowingly and wilfully make or cause to be made any false or fraudulent statements or representations in any matter within jurisdiction of any agency of the United States.

CAB Form T-88
(Rev. 2-67)

CLASS RATE PROFIT SHARING SCHEDULE

PROFIT SHARING COMPUTATION

Carrier Trans-Texas Airways, Inc. Year ended December 31, 1966

		Step I *	Step II	Step III	Step IV	Step V
1.	Income after tax, before profit sharing, per Schedule B	894,254				
2.	Percent of investment (1 ÷ 9)					
	Investment					
3.	Debt (Schedule W)	7,459,154				
4.	Convertible debentures (Schedule W)	224,232				
5.	Preferred equity (Schedule W)					
6.	Common equity (Schedule W)	4,271,799				
7.	Adjust. to common equity (30% of line 31)					
8.	Common equity, as adjusted (6 - 7)	4,271,799				
9.	Investment (3 + 4 + 5 + 8)	11,955,185				
	Return Element					
10.	Debt (5.75% X 3)	428,901				
11.	Convertible debentures (6.50% X 4)	14,575				
12.	Preferred equity (7.50% X 5)	-				
13.	Common equity (16.00% X 8)	683,488				
14.	Return element (10 + 11 + 12 + 13)	1,126,964				
15.	Percent of investment (14 ÷ 9)					
16	Return at 11.00 per cent	1,315,070				
17.	Return at 9.00 per cent	1,075,967				
18.	Return at 3¢ per mile	511,173				
19.	"D" return element*	1,126,964				
20.	Earnings deficiency (19 exceeds 11)	232,710				
	Profit Sharing					
21.	Profit to "D"					
22.	"D" to 13.5 per cent					
23.	Over 13.5 per cent					
24.	Total					
	Carrier Share					
25.	Profit to "D" (100% X Line 21)					
26.	"D" to 13.5% (50% X Line 22)					
27.	Over 13.5% (25% X Line 23)					
28.	Net profit to carrier					
	Government's Share					
29.	"D" to 13.5% (50% X Line 22)					
30.	Over 13.5% (75% X Line 23)					
31.	Government share before tax reduction					
32.	Tax reduction**					
33.	Total to be refunded					

* Higher of 14, 17 or 18, provided that the computed return (14) does not exceed an amount equivalent to 11.00 per cent of recognized investment (16).

** Show derivation of composite tax rate.

Schedule A

CAB Form T-88
(Rev. 2-67)

CLASS RATE PROFIT SHARING SCHEDULE
INCOME TAX ADJUSTMENT - SUMMARY

Carrier Trans-Texas Airways, Inc. Year ended December 31, 1966

	Federal	State	Total
I. Income Tax Adjustment:			
1. Taxes per returns a/ (before investment tax credit)	696,847	6,222	703,069
2. Taxes (credits) applicable to difference between gross formula subsidy and current-year subsidy reported on tax returns b/	42,266		42,266
3. Sub-total	739,113	6,222	745,335
Adjustments:			
4. Taxes applicable to capital gains on flight equipment. See Schedule T	(57,018)		(57,018)
5. Taxes applicable to non-transport ventures. See Schedule S			
6. Taxes applicable to out-of-period subsidy and other income not otherwise considered for profit-sharing. See Schedule U			
7. Credits (taxes) applicable to profit sharing of prior years, if included on line 1. See Schedule U c/			
8. Adjusted taxes to Schedule B	682,095	6,222	688,317
II. Investment Adjustment as at December 31			
9. Taxes as reported in Accounts 9191.1 and 8186, Form 41	709,824	6,222	716,046
10. Taxes (credits) applicable to cumulative difference between gross formula subsidy and current-year subsidy as reported on Form 41, if not included on line 9	42,266		42,266
11. Adjusted taxes (line 9 + 10)	752,090	6,222	758,312
12. Difference line 11 over line 3 (to line 23, Schedule W)	12,977		12,977

a/ As indicated below provide a breakdown of the gross receipts as reported on the Federal tax return and reconcile with the operating revenues as reported on Form 41.

	Tax Return $	Form 41 $	Difference* $
Passenger & excess baggage			
Property			
Charters			
Incidental and other			
Federal subsidy			
Total	$	$	$

*Submit detailed explanation.

b/ Gross formula subsidy $ 5,391,725
Current-year subsidy 5,303,670
Difference $ 88,055

c/ Credits must not exceed the tax reduction previously reflected in the profit-sharing determination. Submit a reconciliation.

NOTE: Show derivation of taxes and/or credits as claimed on lines 2 and 10.

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THIS PAGE NOT USED.

CIVIL AERONAUTICS BOARD
WASHINGTON, D.C. 20428

IN REPLY REFER TO:
B-40-46

January 22, 1968

Mr. H. H. Farr, Treasurer
Trans-Texas Airways, Inc.
International Airport
Houston, Texas 77060

Dear Mr. Farr:

Our auditors have examined the accounts and other records of Trans-Texas Airways, Inc., for the period January 1, 1966, through December 31, 1966.

This letter contains only comments on the accounting aspects of our audit findings. Thus, except to the extent that under the terms of the class rate the accounting determination is controlling, this letter does not purport to resolve the treatment of the profit-sharing or other class rate aspects of the items covered herein. These findings, along with the audit findings relating to class rate matters, together with your comments and our recommendations, have been forwarded to the Bureau of Economics for consideration in processing your Form T-88 for the year 1966.

The resolved conformity findings are listed in the appendix to this letter. The unresolved conformity finding is discussed below.

Misclassification of Restricted Funds

During 1966, Trans-Texas sold various aircraft engines and recorded the proceeds in "Account 1011 Cash-Chase Collateral" as security for the release of the engines from a chattel mortgage. The balances in Account 1011 that had not been released by the bank were $101,500 at March 31, 1966, $8,000 at June 30, 1966, and $18,000 at September 30, 1966.

The funds were subsequently released by the bank for reimbursement of costs of Dart engines mortgaged under supplemental chattel mortgages.

Since the collateral funds were not available for current use, our auditors informed you that the funds should have been recorded in "Account 1550 Special Funds-Other."

You stated your position as follows:

"Trans-Texas does not agree with the auditor's contention that the funds in the Chase collateral bank account are equipment replacement funds.

Mr. H. H. Farr (2)

"The Chase Collateral account was established for the purpose of complying with the credit agreements dated in 1964 and 1966 as recorded in the Chattel Mortgage, Art. 2, Sec. 2.2.

"In addition the amount on deposit can be released for 'current operations' merely by a letter as provided in Art. 2, Sec. 2.2 of the Chattel. The requirement was established for bank protection in the event the Company should sell mortgaged flight equipment. The Company is not in violation of mortgage requirements and it is an easy matter to get the funds released."

Regardless of how easy it is to get the funds released, the fact remains that they had not been released by the bank at the above balance sheet dates. In addition to not being available for current use, the funds were required for noncurrent assets. Thus, we request that such funds be recorded in Account 1550 in the future.

Please advise us of the corrective action taken on the above item and the items discussed in the appendix.

We appreciate the excellent cooperation extended our auditors during the examination.

Very truly yours,

Warner H. Hord
Director, Bureau of Accounts
and Statistics

Enclosure

APPENDIX

Improper Accounting for Convair Conversion Costs

Trans-Texas is converting 25 CV-240 aircraft into CV-600 aircraft. The first CV-240 was removed from transport service for conversion late in 1965 and nine more were removed during 1966. At December 31, 1966, eight conversions had been completed and the aircraft returned to transport service.

While each aircraft was in conversion, one phase of a four-phase overhaul was performed. The period out of service ranged from two to three months, except for the first conversion (N94253) which took considerably longer.

Depreciation on the CV-240 airframes continued during the conversion period. The net book value of the CV-240's remained in "Account 1601 Airframes" until the converted aircraft were ready for transport service. At that time, the net book values of the CV-240's were transferred from Account 1601 to "Account 1689 Construction Work in Progress." Conversion costs were also recorded in Account 1689. The conversion costs and net book value of the airframes were then transferred from Account 1689 to CV-600 Account 1601.

The communications and navigational equipment used on CV-240's was also usable on CV-600's. While each aircraft was undergoing conversion the cost of its communications and navigational equipment was recorded in "Account 1604 Aircraft Communications and Navigational Equipment" and provisions for depreciation thereon were charged to operating expense.

Our auditors informed you that, in their opinion, the recording of depreciation for the CV-240 airframes and communications and navigational equipment should have ceased on the day the aircraft were withdrawn from service, and the net book value thereof should have been transferred to Account 1689.

You replied to this audit finding as follows:

Airframes.

"Trans-Texas does not agree with the auditor's contention that aircraft in conversion should be immediately transferred to Account 1689. This exception is the same as taken from 1965 in RAF #4. Our position has remained unchanged as follows. At the time an aircraft is pulled for conversion, it is our policy to schedule these aircraft so that a major overhaul of the airframe can be performed at the same time. In fact, we might state that the conversion is done simultaneously with the overhaul of the airframe. In other words, the conversion is scheduled to coincide with the expiration of the Built-In Overhaul.

"We have had a number of years experience in the overhaul of airframes and realize that it takes normally thirty days and in some instances as much as forty days to perform an airframe overhaul on our Convairs. Taking this into consideration we see no justification for removing the aircraft from active service during the first thirty to forty days since overhauls on airframes does not constitute an inactive aircraft as outlined in the Uniform System of Accounts. Any time an aircraft goes in for a major overhaul of the airframe the aircraft is continued to be counted in active service to arrive at total fleet utilization and no adjustment is made for depreciation or investment purposes. In view of this, coupled with the fact that we perform the conversion at the same time that we are overhauling the airframe it is completely unfair to remove the investment of the aircraft for at least the first thirty days.

"It would seem to us the only practical solution to this problem and to be completely fair to Trans-Texas and to the CAB that any adjustment should be on the basis of any timeouts in excess of thirty days. If the CAB auditor and the CAB staff would amend their exception to read, 'in excess of thirty days' we would certainly be agreeable to this and feel that this would be equitable to both sides."

Communications and Navigational Equipment

"Trans-Texas does not agree with the auditor's conclusion that communication and navigation equipment should be removed from our investment base while the aircraft is in conversion. The auditor's argument that the same basis applies in rotables, etc., as in airframe is incorrect. Communication and navigation equipment is not assigned to 'an' aircraft, but may be placed on any aircraft for which it is suited. It is a fact that all equipment of this nature is removed from an aircraft while in conversion and placed in the normal issue channel. There is no indication that a part removed from a CV-240 will be put on the same aircraft as a CV-600. In fact, parts are removed from aircraft in conversion (and sometimes checks) in order to keep line aircraft operable. It should further be noted that this equipment has no bearing on the conversion but is removed during the overhaul process."

We agree that the Uniform System of Accounts (USAR) does not require reclassification of airframe costs, or suspension of depreciation, when an aircraft is out of service for purposes of overhaul only. We acknowledge that it was practical for Trans-Texas to perform the overhaul when the aircraft were out of service for conversion. However, this is not a factor in determining the accounting status of the aircraft during the conversion period. In this audit finding, we are concerned with the

accounting for aircraft which have been withdrawn from scheduled service for the primary purpose of converting them from piston type (CV-240) to turboprop (CV-600).

In your letter dated December 7, 1967 responding to our 1965 conformity letter dated November 29, 1967, you stated that you were accepting our decision regarding the accounting for airframes during the conversion period. You agreed to make all necessary accounting entries, on the airframes, for 1965, 1966 and 1967 in the fourth quarter of 1967.

After a further review of the facts concerning communication and navigation equipment, it was decided to withdraw this portion of our audit finding.

Misclassification of Equipment Purchase Funds

A pre-delivery installment payment to Douglas Aircraft Company, in the amount of $3,150,000, was recorded in "Account 1280 Notes and Accounts Receivable-Other" at December 31, 1966, and was reclassified to "Account 1550 Special Funds-Other" in February 1967.

You agreed to revise Form 41, Schedule B-1, at December 31, 1966, to show the $3,150,000 deposit in Account 1550.

Accounting for Miscellaneous Expenditures Incurred in Connection with the Convair Conversion Program

The costs of import duties, brokerage fees, transportation and insurance on conversion kit details and Rotol propellers and accessories from Great Britain to San Diego or Houston were charged to the flight equipment accounts when billed. In several cases, these costs were recorded in the flight equipment accounts prior to the date the applicable converted CV-600 entered transport service. Provisions for depreciation started at the time the related CV-600 entered transport service.

You agreed that in the future these costs would be accumulated in "Account 1689 Construction Work in Progress" along with other conversion costs until the applicable aircraft went into transport service. At that time, the total accumulated cost will be transferred from Account 1689 to the CV-600 flight equipment accounts.

Deficiencies in Statements of Procedure

Trans-Texas' statements of accounting procedures were deficient in the following areas:

1. No statements of accounting procedures had been filed for:

1. Con't.

a. depreciation of DC-9 flight equipment

b. depreciation of CV-600 flight equipment

c. accounting for airframe and aircraft engine overhauls and airworthiness reserves for the DC-9's and CV-600's.

2. The statement of accounting procedure for CV-240 airframe overhauls, filed with the Board on October 25, 1966, showed FAA-authorized hours as 14,000; however, CV-240 hours were increased to 15,000 hours in March 1966.

3. The statement of accounting procedure for depreciation, filed with the Board on October 25, 1966, showed a service life of 5 years for passenger service equipment, ramp equipment, ground radio equipment and maintenance and engineering equipment. The actual service life used for this equipment in 1966 was 6 years.

You stated that revised statements of procedure on these matters would be filed with the Board in the near future.

Change in Accounting Method Not Reported on Form 41

In the fourth quarter of 1966 Trans-Texas capitalized $317,328 of interest costs applicable to funds invested in aircraft deposits and CV-600 construction. This represented a change in accounting method from prior years when all interest was charged to expense.

The change in accounting method was not explained on Form 41, Schedule B-2 "Notes to Balance Sheet" or Schedule P-2 "Notes to Income Statement," as required by Section 22(i) of the USAR.

You agreed to amend Schedule P-2 for the period ended December 31, 1966, to adequately explain the change and its impact on the financial elements involved.

FLY TRANS-TEXAS AIRWAYS OVER THE
INTERNATIONAL AIRPORT
HOUSTON, TEXAS 77060

SOUTHWEST REGION

February 1, 1968

AIR MAIL

Mr. Warner H. Hord, Director
Bureau of Accounts and Statistics
Civil Aeronautics Board
Washington, D. C. 20428

Dear Mr. Hord:

In re B-40-46

Thank you for your letter of January 22 to Mr. Farr concerning the exception taken in the audit of our 1966 records. This is to advise that we accept your recommendation stated in your letter and will adjust our Forms 41, etc., as required. However, it will be several days before we will be able to rework these forms due to the pressing workload at the present time.

We appreciate the courtesies extended to us by you and your staff during this audit.

Very truly yours,

TRANS-TEXAS AIRWAYS, INC.

B. O. Wilson
Controller

BOW/cb

CIVIL AERONAUTICS BOARD
WASHINGTON, D. C.

REPORT OF FINANCIAL AND OPERATING STATISTICS FOR CERTIFICATED AIR CARRIERS

Period ended September 30, 19 68

TRANS-TEXAS AIRWAYS, INC.
(Full name of reporting company)

CERTIFICATION*

I, the undersigned CONTROLLER
(Title of officer in charge of accounts)

of the TRANS-TEXAS AIRWAYS, INC.
(Full name of reporting company)

do certify that this report and all schedules and supporting documents which are submitted herewith or have been submitted heretofore as parts of this report filed for the above indicated period have been prepared under my direction; that I have carefully examined them and declare that they correctly reflect the accounts and records of the company, and to the best of my knowledge and belief are a complete and accurate statement, after adjustments to reflect full accruals, of the operating revenues and expenses, income items, assets, liabilities, capital, surplus, and operating statistics for the periods reported in the several schedules; that the various items herein reported were determined in accordance with the Uniform System of Accounts and Reports for Certificated Air Carriers prescribed by the Civil Aeronautics Board; and that the data contained herein are reported on a basis consistent with that of the preceding report except as specifically noted in explanations accompanying the financial and statistical statements.

B. O. Wilson
(Signature) B. O. Wilson

P. O. Box 60188, Houston, Texas 77060
(Air Carrier Post Office Address)

Dated November 7, 19 68

*Title 18 U. S. C. Sec. 1001, Crimes and Criminal Procedure, makes it a criminal offense subject to a maximum fine of $10,000 or imprisonment for not more than 5 years, or both, to knowingly and willfully make or cause to be made any false or fraudulent statements or representations in any matter within jurisdiction of any agency of the United States

U. S. GOVERNMENT PRINTING OFFICE : 0? 042 ???

INCOME STATEMENT Group II and Group III Air Carriers	Air Carrier TRANS-TEXAS AIRWAYS Operation DOM-LOC Period Ended September 30, 1968		Air Carrier TRANS-TEXAS AIRWAYS Operation DOM-LOC Period Ended September 30, 1968	
		QUARTER		12 MONTHS TO DATE
OPERATING REVENUES REF.				
TRANSPORT:				
Passenger P-3	3901	8,978,119	3901	32,187,752
United States mail P-3	3902	197,056	3902	788,573
Foreign mail P-3	3903	372	3903	1,910
Property P-3	3906	679,524	3906	1,886,771
Charter and special P-3	3907	126,501	3907	381,755
Other P-3	3919	62,818	3919	197,987
Total transport revenues	3999	9,844,390	3999	35,144,068
NONTRANSPORT:				
Federal subsidy	4100	1,043,606	4100	3,715,844
Incidental revenues (net) P-4	4600	54,739	4600	250,051
Total nontransport revenues	4900	1,098,345	4900	3,965,895
Total operating revenues	4999	10,942,735	4999	39,109,963
OPERATING EXPENSES				
Flying operations P-5.2	5100	3,123,110	5100	11,474,197
Maintenance P-6	5400	1,808,262	5400	6,956,989
Passenger service P-6	5500	604,964	5500	2,183,321
Aircraft and traffic servicing .... P-7 & P-8	6400	2,394,446	6400	8,888,383
Promotion and sales .... P-7 & P-8	6700	832,266	6700	3,005,885
General and administrative P-7	6800	657,690	6800	2,514,596
Depreciation and amortization P-3	7000	721,237	7000	3,158,829
Total operating expenses	7199	10,141,984	7199	38,060,320
Operating profit or loss	7999	800,751	7999	1,049,643
NONOPERATING INCOME AND EXPENSE–NET P-3	8100	651,475*	8100	2,227,280*
Net income before income taxes	8999	149,276	8999	1,177,637*
INCOME TAXES FOR CURRENT PERIOD	9100	96,012	9100	704,536*
Net income before special items	9699	53,264	9699	473,101*
SPECIAL ITEMS:				
Special income credits and debits (net) P-4	9796	1,686	9796	6,744
Special income tax credits and debits (net) P-4	9797	-	9797	-
Net income after special items	9799	54,950	9799	466,357*
UNAPPROPRIATED RETAINED EARNINGS:	2940		2940	
Beginning of period	9820	1,694,611	9820	2,215,918
Cash dividends and other asset distributions P-4	9830	-	9830	-
Stock dividends and retained earnings adjustments P-4	9840	-	9840	-
End of period (including net income)	9899	1,749,561	9899	1,749,561

*Denotes inverse amount, in accounts 8100, 9799, and 2940, denotes debit amount.

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Item	Air Carrier TRANS-TEXAS AIRWAYS Operation NON-LOC Period Ended September 30, 1968	Quarter	Air Carrier TRANS-TEXAS AIRWAYS Operation NON-LOC Period Ended September 30, 1968	12 Months to date
INCOME TAXES	9100		9100	
Income taxes before investment tax credits	91.1	98,887	91.1	930,207°
Investment tax credits utilized	91.2	–	91.2	132,454
Deferred income taxes (see Schedule B-3)	92.9	2,875°	92.9	2,875°
Investment tax credits deferred	93.1	–	93.1	–
Amortization of deferred investment tax credits	93.2	–	93.2	–
Income taxes for current period (to Sch. P-1, Acc't 9100)	93.7	96,012	93.7	795,236°
Income taxes on special items (to Sch. P-1, Acc't 97)	93.8	–	93.8	–
Total income taxes	93.9	96,012	93.9	795,236

MEMORANDUM ALLOCATION OF INCOME TAXES	Line No.	Quarter	Line No.	12 Months to date
Operating profit or loss (per Schedule P-1)	1	800,751	1	1,040,643
Add: Account 87 Interest Expense	2	664,481	2	2,480,690
Total	3	136,270	3	1,450,055°
Income taxes allocated to operating profit or loss after interest expense	4	87,647	4	735,422°
Investment tax credits allocated to cost of service	5	–	5	131,454
Amortization of investment tax credits allocated to cost of service	6	–	6	–
Total lines 4, 5, and 6	7	87,647	7	866,876°
Operating profit or loss after income taxes	8	48,623	8	266,179°
Nonoperating income and expense—net (8199)	9	651,475°	9	2,227,280°
Less: Account 87 Interest Expense	10	664,481	10	2,480,690°
Total	11	13,006	11	261,410
Income taxes allocated to nonoperating income and expense—net	12	8,365	12	182,360
Investment tax credits not allocated to cost of service	13	–	13	–
Amortization of investment tax credits not allocated to cost of service	14	–	14	–
Total lines 12, 13 and 14	15	8,365	15	182,360
Nonoperating income and expense after income taxes	16	4,641	16	79,070

° Denotes inverse amount

U. S. GOVERNMENT PRINTING OFFICE

CAB Form

SCHEDULE P-3(a) SCHEDULE P-3(a) SCHEDULE P-3(a)

BEFORE THE

CIVIL AERONAUTICS BOARD

WASHINGTON, D. C.

In the Matter of the Local Service Class Subsidy Rate Investigation FRONTIER AIRLINES, INC. PROFIT SHARING 1964	Docket 15359

MEMORANDUM OF FRONTIER AIRLINES ON PROFIT SHARING FOR THE YEARS 1964, 1965 and 1966

Communications with respect to this document may be addressed to:

Richard A. Fitzgerald
Senior Vice President and
General Counsel

Gordon Linkon
Vice President Industrial Relations and Associate General Counsel

Frontier Airlines, Inc.
5900 East 39th Avenue
Denver, Colorado 80207

Robert J. Corber
1250 Connecticut Avenue, N. W.
Washington, D. C. 20036
Attorney for Frontier Airlines, Inc.

Steptoe & Johnson
1250 Connecticut Ave., N.W.
Washington, D. C. 20036

Of Counsel.

November 6, 1968.

BEFORE THE

CIVIL AERONAUTICS BOARD

WASHINGTON, D. C.

In the Matter of the Local Service Class Subsidy Rate Investigation FRONTIER AIRLINES, INC. PROFIT SHARING 1964	Docket 15359

MEMORANDUM OF FRONTIER AIRLINES
ON PROFIT SHARING FOR THE YEARS
1964, 1965 and 1966

The accounts of Frontier Airlines have been audited by the Local Service Division for profit sharing in the years 1964, 1965 and 1966. The Division's findings have been made and certain items have been contested by the carrier for the year 1964. 1/

By letters in April and July of this year the Local Service Division indicated its intent to make further adjustments in 1964 covering tax loss carrybacks resulting from operations in 1967. 2/ As of this date no tax refund for the loss carryback has been sought by Frontier.

The purpose of this memorandum is to urge the Board to render an early disposition of the profit-sharing findings

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1/ See Response Of Frontier Airlines, Inc. To Adjustments Proposed By Local Service Division For 1964, Docket 15359, filed July 3, 1967.

2/ Letters dated April 23, 1968 and July 22, 1968, respectively, from the Chief of the Local Service Division to William M. Groody, Vice President-Treasurer of Frontier.

of the Local Service Division for the 1964, 1965 and 1966 years. The Board is aware that Frontier has suffered sizeable operating losses for 1968 and that it is diligently seeking ways to recover from these losses. Its efforts may be impeded by delays in closing mail pay for past years, particularly when the delay raises questions about the use which may be made of tax loss carrybacks.

Under Class Rate IV (Order E-25162) the adjustment of subsidy for tax loss carrybacks and carryforwards no longer applies. Carriers whose past periods have been closed are not confronted with recapture of tax refunds or credits. 3/ These facts underscore the gross inequity of further adjustment of Frontier's profit sharing to account for operating losses incurred from 1967 forward. The inequity is made even larger when it is the delay in disposing of prior year profit sharing which causes this result.

Although, as set out more fully hereafter, Board policy should be construed to prevent the use of tax loss carrybacks for 1967 or later years to increase profit sharing in earlier years, the only real protection available to the carrier is an order closing out mail pay for the earlier years. Such protection is essential to remove the uncertainty and financial jeopardy created by the threat of CAB capture of tax loss carrybacks -- which seriously impair efforts of the Company to overcome the effects of operating losses beginning in 1967.

The Board has previously expressed its concern about recaptured earnings from prior years. In fact, it has declined to recapture "excess" profits of subsidized carriers

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3/ Principally those carriers who were not in a profit-sharing status.

uncertainty, which compound difficulties encountered in recent periods of operating losses, can be avoided by an early decision on profit sharing for 1964, 1965 and 1966.

The issues readily lend themselves to early decision. They are discussed below.

The Class Rate Does Not Require The Application Of 1967 Tax Loss Carrybacks To Prior Years

(a) Frontier Has Not Filed For A Tax Loss Carryback

Section III E 1. of Order No. E-21227[4/] provides that "loss carrybacks" will be taken into account on the basis of "tax returns submitted to taxing authorities for each year, with such amendments and revisions as may have been filed as of the final determination of profit-sharing hereunder . . ." In other words, the loss carryback is considered provided it has "been filed" at the time it is taken into account. There has been no amendment of the 1964 return by Frontier for purposes of a loss carryback from 1967. Accordingly the carryback is not covered by the order.

This objection has more than technical significance. It is based upon the fact that the provisions of the Class Rate III order were not designed to reach every conceivable tax benefit a carrier may possibly receive; instead the order is limited to actual tax changes which are specifically determinable to the extent that they have been reduced to a written filing as of the time of the final determination of profit sharing. Indeed, even that was changed after 1966. It is singularly significant that Class Rate IV, effective

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4/ The order establishing Class Rate III.

as of January 1, 1967, does not include any redeterminations of any kind on the basis of tax revisions after January 1, 1967 (Order E-25162).

Class Rate IV provides a formula for determining gross subsidy based upon the operations of the carrier as measured by such factors as time, stations served, departures flown, passengers originated, revenue ton miles flown and available seat miles flown. It then departs substantially from prior class rates by prescribing an adjustment of gross subsidy according to revenue growth experienced by carriers. The concept of profit sharing is abandoned along with its related provisions for an actual tax policy or adjustments based upon revisions in taxes paid or payable.

This change is highly significant in this case. What the change means is that tax refunds after January 1, 1967 will not be used by the Board to reduce subsidy. However, the Local Service Division has suggested that a potential tax refund (loss carryback) for operations in 1967 - a Class Rate IV year - may be used to reduce subsidy for prior Class Rate years.

This contention cannot be made for subsidy in 1967 or future years. If, notwithstanding this fact, it were applied to prior years, the inequities would be legion. Nothing could be devised that would so perniciously discriminate against one carrier in favor of others on grounds totally lacking in rationality.

If this concept were adopted, tax refunds could be captured for loss carrybacks attributable to 1967 but not for loss carryovers to future years. The result would be that two carriers with the same profits and the same losses over a period covering both Class Rate III and Class Rate IV could

receive radically different subsidy treatment based solely on the accident of years in which profits or losses were realized. For example, take Carrier A and Carrier B which had the same aggregate losses and the same aggregate profits in the years shown:

Year	Carrier A	Carrier B
1964	Loss	Profit
1965	Loss	Profit
1966	Loss	Profit
1967	Profit	Loss
1968	Profit	Loss

In this situation Carrier A would obtain a tax refund for the carryforward of losses to years 1967 and 1968 and the refund would not be captured by the Board. However, Carrier B, with the same aggregate tax refund, would lose the refund by reason of subsidy reduction even though both carriers, by hypothesis, had the same total profits and the same total losses.

A similar disparity of treatment could arise out of differences in accounting practices. The carrier adopting more conservative depreciation practices prior to 1967 followed thereafter by more accelerated depreciation resulting in losses could be required to pay the tax benefits to the Board while another carrier reversing these practices could avoid such payment. 5/

Illustrations could be multiplied but they all point to the fact that the application of 1967 tax losses to prior years would lead to flagrantly discriminatory treatment of carriers; and the results would not have a reasonable relation to the carriers' actual subsidy needs or to the promotion of the public interest.

Another inequity which the carryback of 1967 tax losses

5/ It should be noted that Frontier has not claimed accelerated depreciation in its tax filings.

would produce is the double recapture of funds from the carrier for the same operations. The revenue sharing feature of Class Rate IV enables the Board to recapture carrier earnings even when the carrier loses money. That is, any increase in revenues in 1967 over fiscal year 1966 (the Class Rate IV base year) entitles the Board to a reduction of subsidy and any loss in income (as opposed to revenues) falls solely on the carrier. Any tax carryback of 1967 losses would give the Board the benefit of subsidy refunds due to revenue increases in 1967 plus the refund of subsidy payments for prior years resulting from tax loss carrybacks accruing in part as a result of subsidy reductions occurring in 1967. Such a double bite at the carrier is a grossly inequitable penalty. Frontier seeks no more than avoidance of the penalty which would result from the recapture of the benefits of the tax loss carrybacks occurring in the years in which Class Rate IV is applicable.

The fact is that current Board policy not only does not indicate these inequities, it is opposed to such consequences. Class Rate IV clearly evidences the intent of the Board to abandon any adjustments required by an actual tax policy. It would be wrong to subvert that obvious intent by using tax benefits arising out of Class Rate IV years, when tax refunds are not subject to capture, to further increase subsidy adjustments for prior Class Rate years. Any tax adjustments arising out of operations in 1967 or future years should not be applied to profit sharing in years preceding 1967.

(b) The Concept Of The 1967 Loss Carryback To Prior Years Takes Unfair Advantage Of Frontier's Merger With Central

The merger of Frontier and Central on October 1, 1967

resulted in substantial losses for 1967 attributable to operations over the former Central routes and to serious operational difficulties arising out of deficiencies in Central's flight and ground equipment. In addition, the initial costs of integration of the routes and personnel of the two carriers were incurred in 1967 resulting in increased losses for 1967. These losses are included in the 1967 deficits incurred by Frontier. Since Central's subsidy mail pay for 1964 was closed, any loss carryback it would have experienced in 1967 could not be applied to profit sharing in the prior year. Yet, simply because Frontier's rates are open for past years, it is faced with the prospect of having its profit sharing increased by reason of such carrybacks. Thus, under the carryback concept, Frontier would be faced with increased profit sharing for 1964 which it would not have had except for the 1967 merger. The inequity and injury to Frontier is manifest.

An ad hoc adjustment of Frontier's subsidy in the amount of some $360,000 annually accompanied approval of the merger. It is simply not proper to add to that the capture of any tax benefits Frontier may realize from operating losses directly attributable to the merger and the merged operations.

The net effect of the application of the tax carryback concept to Frontier after 1967 is to pool the interests of Central with Frontier and thereby take tax benefits for years in which subsidy is closed for Central. If this would be proper, it would be equally correct to have a pooling of interests of the two carriers in the prior year (1964) with adjustment of Frontier's subsidy to give it the benefit of the Central deficiency.[6/]

Frontier is not asking for such a result. All it asks is that Class Rate IV be applied to all operations after

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6/ Central had a deficiency in 1965 as well and a pooling of interests would also be appropriate for that year.

CIVIL AERONAUTICS BOARD
WASHINGTON, D. C.

REPORT OF FINANCIAL AND OPERATING STATISTICS FOR CERTIFICATED AIR CARRIERS

Period ended September 30, 19 68

FRONTIER AIRLINES, INC.
(Full name of reporting company)

CERTIFICATION*

I, the undersigned William M. Groody, Vice President - Treasurer
(Title of officer in charge of accounts)

of the FRONTIER AIRLINES, INC.
(Full name of reporting company)

do certify that this report and all schedules and supporting documents which are submitted herewith or have been submitted heretofore as parts of this report filed for the above indicated period have been prepared under my direction; that I have carefully examined them and declare that they correctly reflect the accounts and records of the company, and to the best of my knowledge and belief are a complete and accurate statement, after adjustments to reflect full accruals, of the operating revenues and expenses, income items, assets, liabilities, capital, surplus, and operating statistics for the periods reported in the several schedules; that the various items herein reported were determined in accordance with the Uniform System of Accounts and Reports for Certificated Air Carriers prescribed by the Civil Aeronautics Board; and that the data contained herein are reported on a basis consistent with that of the preceding report except as specifically noted in explanations accompanying the financial and statistical statements.

William M. Groody
(Signature)

5900 East 39th Avenue
Denver, Colorado 80207
(Air Carrier Post Office Address)

Dated November 8, 19 68

*Title 18 U. S. C. Sec. 1001, Crimes and Criminal Procedure, makes it a criminal offense subject to a maximum fine of $10,000 or imprisonment for not more than 5 years, or both, to knowingly and willfully make or cause to be made any false or fraudulent statements or representations in any matter within jurisdiction of any agency of the United States.

INCOME STATEMENT Group II and Group III Air Carriers		Air Carrier Frontier Airlines, Inc. Operation Dom-Local Period Ended September 30, 19[illegible]		Air Carrier Frontier Airlines, Inc. Operation Dom-Local Period Ended September 30, 19[illegible]
		QUARTER		12 MONTHS TO DATE
OPERATING REVENUES				
SCE.				
TRANSPORT:				
Passenger — P-3	3901	15,508,915	3901	54,322,883
United States mail — P-3	3902	358,789	3902	1,433,017
Foreign mail — P-3	3903	-0-	3903	-0-
Property — P-3	3906	736,836	3906	2,480,588
Charter and special — P-3	3907	528,069	3907	2,272,388
Other — P-3	3919	170,718	3919	515,676
Total transport revenues	3999	17,303,327	3999	60,9[illegible],350
NONTRANSPORT:				
Federal subsidy	4300	1,882,120	4300	7,710,013
Incidental revenues (net) — P-4	4800	138,141	4800	380,038
Total nontransport revenues	4900	2,020,261	4900	8,090,051
Total operating revenues	4999	19,323,588	4999	69,086,401
OPERATING EXPENSES				
Flying operations — P-5.2	5100	5,076,039	5100	18,928,657
Maintenance — P-6	5400	4,628,583	5400	15,425,441
Passenger service — P-6	5500	1,368,115	5500	5,165,980
Aircraft and traffic servicing — P-7 & P-8	6400	4,171,035	6400	15,165,988
Promotion and sales — P-7 & P-8	6700	1,740,953	6700	6,409,711
General and administrative — P-7	6800	967,178	6800	3,554,854
Depreciation and amortization — P-3	7000	1,920,655	7000	6,443,333
Total operating expenses	7199	19,852,558	7199	71,169,364
Operating profit or loss	7999	528,970 *	7999	2,082,763 *
NONOPERATING INCOME AND EXPENSE — NET — P-3	8100	1,398,320 *	8100	4,184,963 *
Net income before income taxes	8999	1,927,290 *	8999	6,267,726 *
INCOME TAXES FOR CURRENT PERIOD	9100	695,000 *	9100	2,385,605 *
Net income before special items	9699	1,232,290 *	9699	3,882,121 *
SPECIAL ITEMS				
Special income credits and debits (net) P-4	9796	-0-	9796	-0-
Special income tax credits and debits (net) — P-4	9797	-0-	9797	-0-
Net income after special items	9799	1,232,290 *	9799	3,882,121 *
UNAPPROPRIATED RETAINED EARNINGS:	2940		2940	
Beginning of period	9810	100,318 *	9810	2,549,513
Cash dividends and other asset distributions — P-4	9830	-0-	9830	-0-
Stock dividends and retained earnings adjustments — P-4	9840	-0-	9840	-0-
End of period (including net income)	9899	1,332,608 *	9899	1,332,608 *

*Denotes reverse amount; in accounts 8100, 9780, and 2940, denotes debit amount.

	Frontier Airlines, Inc. Non-Local Period Ended September 30, 1969		Frontier Airlines, Inc. Non-Local Period Ended September 30, 1968	
Item		Quarter		12 Months to date
INCOME TAXES				
Income taxes before investment tax credits	91.1	615,603 *	91.1	4,687,387 *
Investment tax credits utilized	91.2	153,603 *	91.2	1,279,282 *
Deferred income taxes (per Schedule B-3)	91.3	-0-	91.3	1,221,000 *
Investment tax credits deferred	91.4	-0-	91.4	636,000 *
Amortization of deferred investment tax credits	91.5	233,000 1/	91.5	233,000
Income taxes for current period (to Sch. P-1, Acct 91[illegible]	91.7	695,000 *	91.7	2,385,605 *
Income taxes on special items (to Sch. P-1, Acct 97[illegible]	91.8	-0-	91.8	-0-
Total income taxes	91.9	695,000 *	91.9	2,385,605 *

MEMORANDUM ALLOCATION OF INCOME TAXES	Line No.	Quarter	Line No.	12 Months to date
Operating profit or loss (per Schedule P-1)	1	528,970 *	1	2,082,765 *
Add: Account 87 Interest Expense	2	1,303,252	2	4,389,822
Total	3	1,832,222 *	3	6,472,587 *
Income taxes allocated to operating profit or loss after interest expense	4	802,258 * 2/	4	3,228,638 *
Investment tax credits allocated to cost of service	5	166,123 *	5	853,171 *
Amortization of investment tax credits allocated to cost of service	6		6	
Total lines 4, 5, and 6	7	661,136 *	7	2,385,467 *
Operating profit or loss after income taxes	8	1,172,086 *	8	3,906,320 *
Nonoperating income and expense-net (8100)	9	1,381,330 *	9	4,124,963 *
Less: Account 87 Interest Expense	10	1,303,252	10	4,389,822
Total	11	98,068 *	11	265,059
Income taxes allocated to nonoperating income and expense-net	12	43,349 * 2/	12	200,751
Investment tax credits not allocated to cost of service	13	2,431 *	13	19,389
Amortization of investment tax credits not allocated to cost of service	14	-0-	14	-0-
Total lines 12, 13 and 14	15	31,881 *	15	180,867
Nonoperating income and expense after income taxes	16	60,204 *	16	24,197

* Denotes inverse amount

1/ See notes to balance sheet
2/ Allocation of lines 91.1 and 91.9

SUPERSEDED
5-5-69

Air Carrier Continental Airlines, Inc
Operation DOM-LOCAL
Period Ended Sept. 30, 1968

Item		Quarter		12 Months to date
INCOME TAXES	9100		9100	
Income taxes before investment tax credits	91.1	625,608*	91.1	4,017,387*
Investment tax credits utilized	91.2	153,608*	91.2	1,279,782*
Deferred income taxes (see Schedule B-1)	92.9	456,000	92.9	755,000*
Investment tax credits deferred	93.1	233,000	93.1	403,000*
Amortization of deferred investment tax credits	93.2	-0-	93.2	-0-
Income taxes for current period (to Sch. P-1, Acct 9100)	93.7	695,000*	93.7	2,385,605*
Income taxes on special items (to Sch. P-1, Acct 97)	93.8	-0-	93.8	-0-
Total income taxes	93.9	695,000*	93.9	2,385,605*

MEMORANDUM ALLOCATION OF INCOME TAXES	Line No.	Quarter	Line No.	12 Months to date
Operating profit or loss (per Schedule P-1)	1	528,970*	1	2,082,765*
Add: Account 67 Interest Expense	2	1,304,252	2	4,390,022
Total	3	1,833,222*	3	6,472,787*
Income taxes allocated to operating profit or loss after interest expense	4	1,028,816*	4	3,451,195*
Investment tax credits allocated to cost of service	5	367,739* 1/	5	884,787*
Amortization of investment tax credits allocated to cost of service	6	-0-	6	-0-
Total lines 4, 5, and 6	7	361,077*	7	2,566,408*
Operating profit or loss after income taxes	8	1,172,145*	8	3,906,379*
Nonoperating income and expense--net (8199)	9	1,398,320*	9	4,184,963*
Less: Account 67 Interest Expense	10	1,304,252	10	4,390,022
Total	11	94,068*	11	205,059
Income taxes allocated to nonoperating income and expense--net	12	52,792*	12	188,808
Investment tax credits not allocated to cost of service	13	18,865* 1/	13	8,005
Amortization of investment tax credits not allocated to cost of service	14	-0-	14	-0-
Total lines 12, 13 and 14	15	33,923*	15	180,803
Nonoperating income and expense after income taxes	16	60,145*	16	24,256

* Denotes income amount

1/ Allocation of Lines 91.2 and 93.1

REVISED 5-5-69

COPY

CIVIL AERONAUTICS BOARD
Washington, D.C. 20428

April 18, 1969

AIR MAIL

Mr. Robert J. Sherer
President
Texas International Airlines
Box 60188
Houston, Texas 77060

Dear Mr. Sherer:

Re: 1966 Class Rate Profit-Sharing,
Dockets 16750 and 15359

The Board's Field Audits Division has completed its audit of Trans-Texas Airways, Inc., and has submitted its findings for the year ended December 31, 1966, under the class rate. Upon consideration of these findings and your C.A.B. Form 41 and T-88, the profit-sharing for 1966, under the provisions of the Local Service Class Subsidy Rate, Dockets 16750 and 15359, Order E-23850, has been tentatively determined to be $320,255. This amount compares with the earnings deficiency of $232,710 reported by Trans-Texas.

Before we proceed further, we want you to have the opportunity to assess the facts upon which we have relied in reaching the results mentioned above. Accordingly, we have enclosed revised C.A.B. Forms T-88 with explanatory notes to the adjustments, for Schedules A, B, C, D, Q, R, V-1, V-2 and W.

We plan to finalize the foregoing promptly. However, if you have any additional information, properly supported, which might alter the facts we relied on, we will consider this information if sent to us within 15 days from the date of this letter.

To enable us to complete our review of your profit-sharing for 1966, we have need of a copy of TTA's 1968 federal tax return. If this return is not currently available, please submit a pro forma return for 1968. Accompanying any pro forma submission

COPY

Mr. Robert J. Sherer (2)

should be a statement setting forth the bases for construction of the estimated tax and that the estimate fairly represents the final tax position the company intends to file with Internal Revenue.

A copy of this letter and the attachments together with your reply, will be placed in the public file.

Sincerely yours,

/s/ Harry H. Schneider

Harry H. Schneider
Chief, Local Service Division
Bureau of Economics

Trans-Texas Airways, Inc.

Reconciliation of Profit to Subsidy per Carrier to Profit to Subsidy per Staff

Year 1966

			Step I
Earnings Deficiency per Trans-Texas CAB Form 1-88 dated April 10, 1967			$ -232710
Staff Adjustments			
Income Elements:			
Adjustment for subsidy revenue			-47725
CV-240 depreciation on aircraft withdrawn from service for conversion to CV-600's			13311
Net overstatement of depreciation after prior year adjustments			22463
Nonallowable expenses paid through the Aero Sales Division			7500
Amortization of developmental and preoperating costs			13805
Recognition of ground equipment losses			-979
Taxes after carryback of 1968 net operating loss adjustment			576002
Taxes on difference between formula and current year subsidy			22811
Taxes applicable to capital gains on flight equipment			760
Investment Elements	Average Investment	Rate of Return	
Identified as Debt Debentures or Equity:			
Adjust for equipment replacement funds - gains	25886	16.00 %	4142
Net book values of CV-240's at date taken out of service	265471	5.75	15264
Equipment before entry in service	134396	5.75	7728
Out-of-period subsidy	299486	16.00	47915
Amortization of develop. & preoperating costs	123	16.00	20
Prior year depreciation adjustment	-83128	16.00	-13300
Cumulative difference, gross and current year subsidy	-10280	16.00	-1645
Erroneous recording of gains on sale of parts	1399	16.00	224
Investment increase for CV-240 depreciation adjustment	-6365	16.00	-1018
Interest expensed in 1965 and capitalized in 1966	4797	16.00	767
Adjust for actual tax liability	-204732	16.00	-32757
Carrier error in transposition of debt portion of investment from Schedule W to Schedule A	-36000	5.75	-2070
Prorated on Debt-Debentures-Equity Ratio:			
Investment in Magic Valley Frozen Food, Inc. 107			
Debt	66	5.75	4
Debenture	2	6.50	-
Equity	39	16.00	6
Equipment replacement funds excluding gains 5999			
Debt	3681	5.75	212
Debenture	116	6.50	8
Equity	2192	16.00	351
Special deposits, funds, organization expenses 393750			
Debt	242039	5.75	13917
Debenture	7599	6.50	494
Equity	144113	16.00	23058
Carried Forward	790999		673271

Trans-Texas Airways, Inc.

Reconciliation of Profit to Share & Carrier to Profit & Share per Staff

Year 1965

		Average Investment	Rate of Return	Step I
Investment Elements: (continued)				
Balance Forward		790894		673271
Non-capitalized tooling and prop. costs	1486			
Debt		913	5.75	52
Debenture		29	6.50	2
Equity		544	16.00	87
Profit Ratio Changes				
Debt		-12616	5.75	-726
Debenture		727	6.50	47
Equity		11889	16.00	1902
Total Staff Adjustments		$ 792295		$ 674635
Profit to Share per Staff				$ 44935

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(Rev. 2-07)

CLASS RATE PROFIT SHARING SCHEDULE

PROFIT SHARING COMPUTATION

Carrier Trans-Texas Airways, Inc. Year ended December 31, 1966

		Step I	Step II	Step III	Step IV	Step V
1.	Income after tax, before profit sharing, per Schedule B	1,504,202	1,504,202	1,504,202	1,504,202	
2.	Percent of investment (1 ÷ 9)	13.48	13.61	13.62	13.62	
	Investment					
3.	Debt (Schedule W)	6,861,204	6,861,204	6,861,204	6,861,204	
4.	Convertible debentures (Schedule W)	215,759	215,759	215,759	215,759	
5.	Preferred equity (Schedule W)					
6.	Common equity (Schedule W)	4,085,837	4,085,837	4,085,837	4,085,837	
7.	Adjust. to common equity (50% of line 31)		-110,481	-116,418	-116,756	
8.	Common equity, as adjusted (6 - 7)	4,085,837	3,975,356	3,969,419	3,969,081	
9.	Investment (3 + 4 + 5 + 8)	11,162,800	11,052,319	11,046,382	11,046,044	
	Return Element					
10.	Debt (5.75% X 3)	394,519	394,519	394,519	394,519	
11.	Convertible debentures (6.50% X 4)	14,024	14,024	14,024	14,024	
12.	Preferred equity (7.50% X 5)					
13.	Common equity (16.00% X 8)	653,734	636,057	635,107	635,053	
14.	Return element (10 + 11 + 12 + 13)	1,062,277	1,044,600	1,043,650	1,043,596	
15.	Percent of investment (14 ÷ 9)	9.52	9.45	9.45	9.45	
16.	Return at 11.00 per cent	1,227,908				
17.	Return at 9.00 per cent	1,004,562				
18.	Return at 3¢ per mile	511,173				
19.	"D" return element*	1,062,277	1,044,600	1,043,650	1,043,596	
20.	Earnings deficiency (19 exceeds 11)					
	Profit Sharing					
21.	Profit to "D"	1,062,277	1,044,600	1,043,650		
22.	"D" to 13.5 per cent	441,925	447,463	447,612		
23.	Over 13.5 per cent		12,139	12,940		
24.	Total	1,504,202	1,504,202	1,504,202		
	Carrier Share					
25.	Profit to "D" (100% X Line 21)	1,062,277	1,044,600	1043650		
26.	"D" to 13.5% (50% X Line 22)	220963	223,732	223,806		
27.	Over 13.5% (25% X Line 23)		3035	3235		
28.	Net profit to carrier	1,283,240	1,271,367	1,270,691		
	Government's Share					
29.	"D" to 13.5% (50% X Line 22)	220,962	223731	223,806		
30.	Over 13.5% (75% X Line 23)		9104	9705		
31.	Government share before tax reduction	220,962	232,835	233,511		
32.	Tax reduction**			86,744 [1]		
33.	Total to be refunded			320255		

* Higher of 14, 17 or 18, provided that the computed return (14) does not exceed an amount equivalent to 11.00 per cent of recognized investment (16).
** Show derivation of composite tax rate.

[1] Tax Provision as shown on Schedules R and B line 8

Schedule A

CAB Form T-88
(2-67)

CLASS RATE PROFIT SHARING SCHEDULE
SUMMARY INCOME STATEMENT

Carrier Trans-Texas Airways, Inc. Year ended December 31, 19[illegible]

1. Reported operating profit or loss, per Form 41			1398436
2. Adjustment for subsidy revenue			
(a) Formula subsidy a/		5344000	
(b) Reported per Form 41		5303670	
Adjustment (a - b) b/			40330
3. Adjustments per Schedule C			60917
4. Nonoperating income per Schedule Q			91263
5. Special income per Form 41			
6. Out-of-period class rate adjustments (explain fully)			
(a)			
(b)			
(c)			
7. Adjusted income before income taxes			1590946
8. Adjusted income taxes per Schedule R			86744
9. Adjusted net income after taxes, before profit sharing			1504202

To facilitate the adjustment on line 12, Schedule W, the following information should be furnished:

	Quarter Ending				
	March 31	June 30	Sept. 30	Dec. 31	Total
Gross formula subsidy	1317599	1322340	1344991	1359070	5344000
Reported current-year subsidy	1347343 a/	1322391 b/	1344021	1334960 a/	5344000
Difference-cumulative	-29544	-0-	-0-	-0-	-0-
Taxes (credits) cumulative @ 48.34%	14354	———	———	———	——— c/
Net-to line 12, Schedule W	-15190	———	———	———	———

1/ ACCRUAL WAS MILEAGE ADJUSTMENT OF $974
2/ DEDUCT PRIOR YEAR SUBSIDY ADJUSTMENT OF $1,954
3/ ACCRUAL ADJUSTMENT OF ESTIMATED 1965 P/S OF $56310

a/ Before profit-sharing computation. PER CAB FINANCE SECTION
b/ If the Form 41 quarterly reports do not include the reconciliations of Federal Subsidy (Account 4108) on Schedule P-2 as required by Standard Practice Letter 9, revision #1, effective August 13, 1964, these quarterly reconciliations should be appended to this filing.
c/ Total should agree with the amount on line 10, Schedule R.

Schedule B

CAB Form T-88
(3-65)

CLASS RATE PROFIT SHARING SCHEDULE
OPERATING REVENUES AND EXPENSES ADJUSTMENTS

Carrier Trans Texas Airways, Inc. Year ended December 31, 19[illegible]

Reference			
	Revenues		
III A 1	1.	Inconsistent reporting	
III A 3	2.	Nontransport or affiliate (See Schedule D)	
		Total	
	Expenses		
III B 1	1.	Inconsistent reporting	-11973 A/
III B 3a	2.	Prohibited expenses	
III B 3b	3.	Fines, etc.	
III B 3c	4.	Financing costs	
III B 3d	5.	Lobbying costs	
III B 3e	6.	Compensation over $35,000 for chief executive and over $25,000 for others	42,538
III B 3f	7.	Payments in excess of goods or services	
III B 3g	8.	Bonuses	
III B 3h	9.	Nonallowable dues	
III B 3i	10.	Unsuccessful applicant or intervenor in route proceedings	
III B 3j	11.	Witness fees	
III B 3k	12.	Charitable contributions	
III B 3l	13.	Life insurance premiums	7500 B/
III B 3m	14.	Nontransport or affiliate expense (See Schedule D)	
III B 3n	15.	Stock options	
III B 3o	16.	Expense not reasonably related to air service	329 C/
III B 4	17.	Amortization of developmental and preoperating costs (Schedule V-1)	
III B 5	18.	Obsolescence and deterioration reserves	
III B 6a	19.	Affiliate expenses in excess of cost	
III B 6b	20.	Unreasonable non-arms length, etc.. expenses	
III B 6c	21.	Sale and lease-back	
III B 7, 8, and 9	22.	Depreciation in excess of allowable [redacted]	22,463 D/
III B 10	23.	Maintenance to conform to built-in overhaul (Details in Schedule X)	
III C	24.	Plans and other submissions not approved	/
	25.		
	26.		
		Total	60917
		Net Adjustment	60917

SEE SCHEDULE C PAGE 2 OF 2 FOR EXPLANATORY NOTES

Schedule C
PAGE 1 OF 4

CARRIER: TRANS TEXAS AIRWAYS, INC YEAR ENDED: DECEMBER 31, 1966

A/ 1	As reported by carrier - Reversal of 1965 depreciation adjustment recommended in 1965 audit findings and booked by carrier in October, 1966	-25294
2	To reduce airframe depreciation expense on CV-240s, recorded after aircraft were withdrawn from service for conversion to CV-600s (See Schedule W Note F/2)	13311
	Total	-11983
B/	To eliminate salary and other nonallowable expenses paid through the Aero Sales Division (See Schedule D)	7500
C/	As reported by carrier	-13476
	Per staff - See Revised Referenced Schedule V-1	329
D/	To adjust for carrier net overstatement of 1966 depreciation expense per amounts reported by carrier and recognized by staff for the accounts indicated in the attached summary as follows: (See Schedule C Pages 3 and 4)	

	Reported by Carrier	Recognized by Staff	
Depreciation per summary	354803	357624	-2821
Add prior year adjustment reflected in books (See Note A/1 above)	25294	-0-	25294
Current year depreciation	380097	357624	22473

Schedule C
Page 2 of 4

Trans-Texas Airways Inc

Summary of Carrier Reported and Staff Recognized Depreciation for the Accounts Indicated for the Calendar Year 1956

Account No.		① Reported by Trans-Texas for Payroll	② Recognized by Local Service Division Staff	③ Understated	④ Overstated	
		$	$		$	
1203.1	DC-3 Propellers	459	51		408	C-5
1604.1	DC-3 Aircraft Radio	2860	3703	823		C-6
1604.3	DC-3 Radio Equipment	385	11845	12230		C-7
1604.1	DC-3 Distance Measuring Equip.	17552	16185		1367	C-8
1605.1	DC-3 Spare Parts-Airframes	8632	4734		3898	C-9
1605.3	DC-3 Spare Parts-Engines	9460	3303	12763		C-10
1605.5	DC-3 Spare Parts-Other	389	550			
	DC-3 Total	20347	40533	25816	5661	
	DC-3 Net Adjustment			20186		
1203.1-2	CV-240 Propellers	33421	30215		3203	C-11
1604.1-2	CV-240 Radar & Radio	80000	80000			
1605.1-2	CV-240 Spare Parts-Airframes	25312	27439	2127		C-12
1605.3-2	CV-240 Spare Parts-Engines	9129	4129			
1605.5-2	CV-240 Spare Parts-Other	5493	8493			
	CV-240 Total	153361	155336	2127	3203	
	CV-240 Net Adjustment				1076	
1203.1-3	CV-600 Propellers	23413	23413			
1604.1-3	CV-600 Radar & Radio	8677	8677			
1604.2-3	CV-600 Flight Voice Recorders	4393	4393			
1605.1-3	CV-600 Spare Parts-Airframes	8742	8742			
1605.3-3	CV-600 Spare Parts-Engines	3352	3352			
1605.5-3	CV-600 Spare Parts-Other	2590	2590			
	CV-600 Total	51167	51167	-0-	-0-	
	CV-600 Net Adjustment			-0-	-0-	
1604.1-4	DC-9 Radar & Radio	2859	2859			
1605.1-4	DC-9 Spare Parts-Airframes	1715	1715			
1605.3-4	DC-9 Spare Parts-Engines	1215	1215			
1605.5-4	DC-9 Spare Parts-Other	478	478			
	DC-9 Total	6267	6267	-0-	-0-	
	DC-9 Net Adjustment			-0-	-0-	

Schedule C
Page 3 of 4

Trans Texas Airways Inc.

Summary of Carrier Reported and Staff Recognized Depreciation for the Accounts Indicated for the Calendar Year 1964

Account No.		Reported by Trans-Texas for Form 41 [1]	Recognized by Local Service Division Staff	Understated	Overstated	
1632.1	Passenger Service Equipment	227	740	513		C-13
1632.2	Passenger Service Equipment	8	8			
1632.1	Ramp Equipment	27073	24402		2671	C-14
1637.1	Radio-Communications	12632	6343		6295	C-15
1638.1	Maintenance & Engineering	24995	21588		3097	C-16
1635.1	Surface Transport	9999	9999			
1636.1	Furniture & Fixtures	31004	26723		4291	C-17
1632.9	Storage Equipment-Depot	34	84			
1639.1	Miscellaneous Ground Equip.	-0-	162	162		C-15
[illegible]	Maintenance Bldg. Equip.	-0-	139	139		C-13
[illegible]	Hangar	9432	8490		942	C-20
[illegible]	Separated Executive Office	4305	4305			
1646.7	Station Buildings Equipment	156	156			
1646.8	Separated Lincoln Ctr	756	756			
1646.9	[illegible] Buildings & Equipment	-0-	153	153		Explained
	Ground Prop. & Equip. Total	[illegible]	[illegible]	[illegible]	[illegible]	
	Ground Prop. & Equip.-Net adjustment				[illegible]	
	Total Understated or Overstated			[illegible]	[illegible]	
	Grand Total	354803	357[illegible]24	2921		
	Prior Price Year Adjustment reflected in Books	25254	-0-		25254	
	Current Year Depreciation	3[illegible]	357[illegible]24		[illegible]	

1) Except for $187 in 1965, depreciation provisions relate to a/c 1646-9 were accepted as reported by TTA.

Schedule C
Page 4 of 4

CAB Form T-88
(2-67)

CLASS RATE PROFIT SHARING SCHEDULE
NONTRANSPORT AND AFFILIATE ACTIVITIES

Carrier Trans-Texas Airways, Inc. Year ended December 31, 19[illegible]

Division or Affiliate _____
(Separate schedule is to be filled out for each activity)

(1)	Gross revenues and/or dividend income *		140669
(2)	Gross expenses*		126554
(3)	Net profit or loss *(-) before taxes **		34015
(4)	Applicable taxes per ~~schedule C~~ Footnote C/		12791 C/
(5)	Net profit or loss (-) after taxes **		21324
(6)	Investment in non-transport or affiliate activities *	62,352	
(7)	"D" rate of return	34.04%	
(8)	"D" return	9.45	5892

Adjustments required (other than accounting):

A - if line (5) exceeds line (8) no adjustment is required to the reported results.

B - if line (5) is less than line (8)
(a) Delete reported net profit or loss from adjusted nonoperating income and expense-net in Schedule Q.

(b) Delete applicable taxes (line 4 above) from actual taxes in computing adjusted taxes in Schedule R.

(c) Eliminate investment (line 6 above) from Airline investment on Schedule W.

* Revenues, expenses and investment are to be adjusted, if necessary, to correct accounting misclassifications and any inconsistencies with the provisions of Section III of the Class Rate Order.

** This amount should agree with account 8186 as adjusted per Schedule Q. All adjustments should be itemized and fully explained.

C/ REPORTED INCOME FROM NONTRANSPORT VENTURES 26,515
APPLICABLE TAX RATE 48.24%
APPLICABLE TAXES 12,791

CAB Form T-58
(1-62)

CLASS RATE PROFIT SHARING SCHEDULE

NONOPERATING INCOME AND EXPENSE NET

Carrier Trans-Texas Airways Inc. Year ended December 31, 1956

	Account Number	As Reported, per CAB Form 41 Schedule P-3	Adjustment	As Adjusted
Interest charges — airframe ...	8180.1			
Interest charges — other ...	8180.2	---		
Capital gains and losses - Operating property ...	8181.1	187,586	-188,565 [1]	-979 [1]
Capital gains and losses - other ...	8181.2			
Unapplied cost discounts ...	8182	57,231		57,231
Interest income ...	8183	8,311		8,311
Dividend income ...	8184			
Foreign exchange adjustments ...	8185	35		35
Income from nontransport ventures ...	[illegible]	26,515		26,515
Interest on debt principal ...	8187.1	-279,555	279,555	
Amortization of discount and expense on debt ...	8187.2	-11,128	11,128	
Amortization of premium on debt ...	8187.3			
Miscellaneous nonoperating credits ...	[illegible]	150		150
Miscellaneous nonoperating debits ...	8189	-2,756	2,756	
Nonoperating income and expense - net ...	8199	-13,611	104,874	91,263

[1] To adjust for reported capital gains on flight equipment and recognize losses on sale of ground equipment

Capital gains and losses - operating property	$ 187,586
Less: capital gains on flight equipment	-188,565
Ground equipment losses	$ -979

Schedule 8

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CLASS RATE PROFIT SHARING SCHEDULE
INCOME TAX ADJUSTMENT - SUMMARY

Carrier Trans-Texas Airways, Inc. Year ended December 31, 1966

	Federal	State	Total
I. Income Tax Adjustment:			
1. Taxes per returns a/ (before investment tax credit)	121,655 D/	3,412 E/	125,067
2. Taxes (credits) applicable to difference between gross formula subsidy and current-year subsidy reported on tax returns b/	19,355	97	19,455 F/
3. Sub-total	141,013	3,509	144,522
Adjustments:			
4. Taxes applicable to capital gains on flight equipment. See Schedule T	-57,263 G/	-515 H/	-57,778
5. Taxes applicable to non-transport ventures. See Schedule S	-	-	
6. Taxes applicable to out-of-period subsidy and other income not otherwise considered for profit-sharing. See Schedule U			
7. Credits (taxes) applicable to profit sharing of prior years, if included on line 1. See Schedule U c/			
8. Adjusted taxes to Schedule B	83,750	2,994	86,744
II. Investment Adjustment as at December 31			
9. Taxes as reported in Accounts 9191.1 and 8186, Form 41	705,491	4,333	709,824 I/
10. Taxes (credits) applicable to cumulative difference between gross formula subsidy and current-year subsidy as reported on Form 41, if not included on line 9	19,355	97	19,455 F/
11. Adjusted taxes (line 9 + 10)	724,847	4,430	729,279
12. Difference line 11 over line 3 (to line 23, Schedule W)			584,757

a/ As indicated below provide a breakdown of the gross receipts as reported on the Federal tax return and reconcile with the operating revenues as reported on Form 41.

	Tax Return $	Form 41 $	Difference* $
Passenger & excess baggage	20,169,426	20,169,426	
Property	1,597,979	1,597,979	
Charters	44,614	44,614	
Incidental and other	335,209	269,173	66,036
Federal subsidy	$3,203,670	$3,203,670	
Total	$25,350,900	$25,284,864	$ 66,036

*Submit detailed explanation.

b/ Gross formula subsidy $ 3,344,000
Current-year subsidy $ 3,203,670
Difference $ 140,330

c/ Credits must not exceed the tax reduction previously reflected in the profit-sharing determination. Submit a reconciliation.
NOTE: Show derivation of taxes and/or credits as claimed on lines 2 and 10.

See Schedule R Page 2 of 2 for explanatory notes and below:

I/ Federal income taxes 705,491 J/
State income taxes 4333 J/
Total - Reported in Acc 9191.1 CAB Form 41 709824

Arkansas	2711
Louisiana	1510
Mississippi	113
Total	4333

Schedule R Page 1 of 2

CLASS RATE PROFIT SHARING SCHEDULE
INCOME TAX ADJUSTMENT - SUMMARY

CARRIER: TRANS-TEXAS AIRWAYS INC. YEAR ENDED: DECEMBER 31 1966

D/ AS REPORTED BY CARRIER			696947
1965 TAXABLE INCOME AFTER CARRYBACK OF 1967 AVAILABLE NET OPERATING LOSS			1162702
1968 CAB FORM 41 PRELIMINARY REPORT NET OPERATING LOSS - APPLIED TO 1965			2369537
1968 NET OPERATING LOSS AVAILABLE FOR 1966			1166835
1966 TAXABLE INCOME PER TAX RETURN DATED 6/12/67			1532621
1966 RECOGNIZED TAXABLE INCOME			335786
NET LONG TERM CAPITAL GAIN REDUCED BY GAINS TAXED AS ORDINARY INCOME (187,586 - 44,007)			143579
SUBTOTAL			192207
SURTAX EXEMPTION			25000
SUBTOTAL			167207
25 PERCENT OF 143,579			35895
22 PERCENT OF 192,207			42286
26 PERCENT OF 167,207			43474
RECOGNIZED TAXES FOR 1966			121655
E/ AS REPORTED BY CARRIER			6222
1966 RECOGNIZED TAXES AFTER 1968 NOL OPERATING LOSS CARRYBACK	121655	=	17.50 %
1966 REPORTED TAXES BEFORE INVESTMENT TAX CREDIT PER RETURN DATED 6/12/67	691335		

STATE	STATE TAXES PER TAX RETURNS	STATE TAXES AFTER NOL CARRYBACK (17.50%)	
ARKANSAS 1/	2553	449	1/
LOUISIANA	2667	2667	
MISSISSIPPI	145	145	
NEW MEXICO 1/	860	151	1/
TOTALS	6225	3412	3412

1/ STATES WITH CARRY-FORWARD AND CARRY-BACK OPERATING LOSS PROVISIONS

E/ AS REPORTED BY CARRIER			42246
PER STAFF - COMPUTED AT 48.24 PERCENT OF 40,330			19455
G/ AS REPORTED BY CARRIER			57019
STAFF - AS REPORTED IN FEDERAL INCOME TAX RETURN DATED JUNE 12, 1967			
	CAPITAL GAINS ON FLIGHT EQUIPMENT	APPLICABLE TAX RATE	TAX ON FLIGHT EQUIPMENT
SECTION 1231 GAINS	144555	25 %	36140
SECTION 1245 GAINS	44007	48 %	21133
TOTALS	188562		57273
H/ STATE TAXES PER FILED RETURNS AFTER NOL CARRYBACK	6222	= .45 %	
FEDERAL TAXES PER RETURN FILED 6/12/67 AFTER I.T.C. AND NOL CARRYBACK	691335		
PER STAFF - COMPUTED AT 0.90 PERCENT OF 57,273			516

SCHEDULE R
PAGE 1 OF 2

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(Rev. 2-67)

CLASS RATE PROFIT SHARING SCHEDULE

DEVELOPMENTAL AND PREOPERATING COSTS

Carrier Trans-Texas Airways, Inc.

Year ended December 31, 1966

	As at 1/1/66	Quarter ended: 3/31/66	6/30/66	9/30/66	12/31/66	Total
Investment Adjustment-Prorate						
1. Non-recognized amounts in Account 1830 at beginning of year (per schedule V-2)	-50,272					
2. Less: Unsuccessful dockets (amount should have been written-off to Account 8189)		-50,272	-125,432	-29,092	-88,364	
3. Balance forwarded from previous quarter(from line 9)		-75,160	-7,259	-54,272	-19,913	
4. Add: Additions to pending dockets						
5. Less: Amounts included on line 3 which became unsuccessful during the period but were not charged to expense						
6. Reported amortization of amounts on line 3 charged to Account 8189						
7. Reported amortization of amounts on line 3 charged to Account 7074.1						
8. Amounts included on line 3 which become successful during the period (net of applicable amount on line 7)		Dec. 1966 CV-600 6,593	97,816	26-9	56,963	
9. Total Adjustment (to schedule V, line 32)	-50,272	-125,432	-29,092	-88,364	-51,314	
Operating Expense Adjustment						
10. Reported amortization of amounts in Account 1830 charged to Account 7074.1		10,464	20,059	18,507	26,453	75,387
11. Computed amortization per schedule V-2		10,787	19,411	18,505	26,954	75,558
12. Expense adjustment (to schedule C, line 17)		-323	647	2	-3	329
Investment Adjustment-Equity						
13. Unsuccessful dockets, line 2(amount should have been written-off to Account 8189)			323	-324	-326	
14. Balance forwarded from previous quarter (from line 18)						
15. Add: Amounts included on line 3 which became unsuccessful during the period						
16. Less: Reported amortization of unsuccessful amounts						
17. Less: Line 12 - Line 7		323	-647	-2	-3	
18. Total adjustment (to schedule W, line 14)		323	-324	-326	-329	

Schedule V-1

CAB Form T-88
(2-66)

CLASS RATE PROFIT SHARING SCHEDULE
DEVELOPMENTAL AND PREOPERATING COSTS

Carrier Trans-Texas Airways, Inc. Year ended December 31, 1966

Docket Number	Developmental and Preoperating Cost As Of Beginning of Year		Additions During Year by Quarters				Remaining Quarters at Beginning of Year	Amortization Per Quarter Lower of (1 or 2)?	Computed Amortization of Amount Recognized Quarters Ended				
	Reported	Recognized	3/31/66	6/30/66	9/30/66	12/31/66			3/31/66	6/30/66	9/30/66	12/31/66	Year
	1	2	3	4	5	6	7	8	9	10	11	12	13
Dec. 13508 Houston-New Orleans	5,751		932	53,961				3,027		2,022	3,027	3,027	9,076 [5]
Dec. 14303 Valley Area Airport	7,786												
Dec. 15459 Pacific N.W. Service	10,720		1,733		1,933 [N]	1,161 [N]							
Dec. 15932 Marion	1,133		224	2,134 [N]	402 [N]	18,747 [N]							
Dec. 13758 S.W. Area Local Serv.	103,710	103,772 [B]					11.67	8,861	8,887	8,887	8,887	8,887	35,548
CV-240 Direct & Facil. Costs	4,120	3,801					2	1,900	1,900	1,901			3,801
CV-600 Direct & Facil. Costs	24,645		72,371	37,579	-2,769	98,101				6,601	4,541	7,344	20,436 [5]
Dec. 15563 Douglas Arizona				3,831 [N]	99 [N]	5 [N]							
Dec. 16143 Central Route 81				1,294 [N]	375 [N]							1,197	1,197 [5]
BCM Direct & Facil. Costs					-54,963 [N]	-238,624							
Total	157,965	107,573	75,160 [N]	99,791	-54,507	-144,793			10,787	19,411	14,505	20,455	75,558
[N] Non recognized Amounts to Schedule V-1	-50,232		-75,160	-7,259	-59,272	-19,913							

[B] Docket 10758 - Recognized deferred cost at 11/30/63 193,517
Deferred during 1964 4,273
Total Recognized Deferred Costs 197,790
Less: Computed Recognized Amortization December, 1963 -2992
Less: Computed Recognized Amortization for 1964 -35554
Less: Computed Recognized Amortization for 1965 -35552
Total Recognized at 11/1/66 103,792

[5] As Recorded at Carrier in CAB Form 41

Schedule V-2

CAB Form T-98
(Rev. 2-67)

Carrier Trans-Texas Airways, Inc.

CLASS RATE PROFIT SHARING SCHEDULE
INVESTMENT

Year ended December 31, 1966

	Reported Investment Per Form 41	Balance Sheet as of: 1/1/66	3/31/66	6/30/66	9/31/66	12/31/66	Average Investment: Long-term Debt	Convertible Debentures	Preferred Equity	Common Equity	Total
1.	Long-term debt	3,649,065	4,560,420	5,524,227	15,424,300	21,050,000	9,567,845				9,567,845
2.	Convertible debentures	467,400	386,100	236,500	215,100	177,200		290,525			290,525
3.	Preferred equity	-									
4.	Common equity	4,957,288	4,357,554	4,779,984	5,813,562	6,164,924				5,029,302	5,029,302
5.	Total	8,093,753	9,304,074	10,541,311	21,452,962	27,392,124	9,567,845	290,525		5,029,302	14,887,672
	Adjustments										
	Identified As Debt, Debentures, or Equity:										
6.	Notes pay. beyond 3 months (III C 2 a)	50,000	57,896	69,794	69,794	53,561	62,264				62,264
7.	Unamort. disc. & exp. on debt (III C 2 f)	- 44,133	- 46,278	- 54,424	- 44,224	- 186,705	- 65,086				- 65,086
8.	Unamort. disc. & exp. on debentures (III C 2 f)	- 72,197	- 58,940	- 35,214	- 31,436	- 25,381		- 43,609			- 43,609
9.	Equipment replacement funds-gains (III C 2 e) A/		- 80,651	- 4,820	- 15,868					- 25,846	- 25,846
10.	Capital stock expense (III C 2 f): WARRANTS, Net Book Value of CV-240				- 766,795	- 943,875				- 309,683	- 309,683
11.	Net deferred tax chgs. to oper. exp. (III C 2k) W	- 61245	- 460377	- 57987	- 464456	- 96883	- 265,471				- 265,471
12.	Equip. before entry in service (III C 2 i) B/	- 891452	- 337997	- 433282	- 3930,178	- 1293,439	- 1445,976				- 1445,976
13.	Out-of-period subsidy C/	- 312,082	- 312,082	- 301,907	- 295,325	- 266,179				- 299,486	- 299,486
14.	Amort. of dev. & precp. (Sch. V-1, line 18) D/		323	- 324	- 326	- 329				- 123	- 123
15.	Schedule M adjustment										
16.	Depreciation expense - per Schedule E M/	83481	83481	83481	83481	80660				83128	83128
17.	Maintenance expense - per Schedule M										
18.	Cum. dif. gross & current-year subsidy after tax - per Schedule B E/		- 15,295							- 3,824	- 3,824
19.	Inconsistent reporting (III C 1) E/		3900	624	8,684	- 25,066				169	169
20.	Receivables from offic. & direct. (III C 2 i)										
21.	Plans, etc. not approved (III C)										
22.	Other noncurrent liabilities (III C 2 h)										
23.	Adj. for actual tax liability - per Sch. B, line 12 N/	130,015	130,015	130,015	130,015	714,772				203,110	203,110
24.	Carried Fwd.						9853576	246,917		4676707	12,777,200

Schedule M
Page 1 of 5

CAB Form T-60
(Rev. 3-67)

Carrier TRANS-TEXAS AIRWAYS, Inc.

CLASS RATE PROFIT CHANGE SCHEDULE
INVESTMENT

Year ended DECEMBER 31, 1966

		Balance Sheet At (1)					Av	% Investment		
		1/1/66	3/31/66	6/30/66	9/30/66	12/31/66	Long-term Debt	Convertible Debentures	Preferred Equity	Common Equity	Total
24.	Brought Fwd						7,853,576	246,917		4,676,707	12,777,200
25.	Debt-debentures-equity ratio						61.47	1.93		36.60	100.00 %
	Prorated on debt-debentures-equity ratio:										
26.	Nonoperating property (III C 2 b)										
27.	Invest. in affil. or nontransport activities (Schedule-D) W					-860					-107
28.	Receivables from offic. & direct. (III C 2 i)										
29.	Equip. replace. funds exc. gains (III C 2 e) W		-20,648	-1,180	-2,132						-5,999
30.	Spec. dep., funds, organ. ex. (III C 2 f) W	-764,174	-852,679	-1,241,696	-1,240,750	-4,283,301					-1,994,463
31.	Working capital exceed. 3 mos. expenses (III C 2j)										
32.	Nonrec. devel. & prep. (Sch. V-1, line 8) W	-50,272	-125,432	-29,092	-88,364	-51,314					-73,420
33.	Inconsistent reporting (III C 4)										
34.	Cash or other value of life insur. (III C 2d)	-44,918	-44,918	-44,918	-44,919	-54,141					-44,121
35.	Plans, etc. not approved (III C)										
36.	Total prorated adjustments						-992,372	-31,158		-540,870	-1614,400
37.	Total adjusted investment						6,861,204	215,759		4,085,837	11,162,800

Schedule P
Page 2 of 5

CLASS RATE PROFIT SHARING SCHEDULE – INVESTMENT – EXPLANATORY NOTES TO SCHEDULE W

CARRIER: TRANS-TEXAS AIRWAYS, INC. YEAR ENDED: DECEMBER 31, 1966

	1/1/66	3/31/66	6/30/66	9/30/66	12/31/66	AVERAGE
A/ To eliminate gains from the sale of flight equipment, recorded in the carrier's cash account		-90857	-6820	-15429		-25702
B/ 1. As reported by carrier	-891452	-337997	-336611	-3468609	-1314753	-1311580
2. To reverse carrier adjustment for that portion of capitalized interest expensed in 1965 and recorded in Account 1699 in 1966 (See Note E/3)					38377	4797
3. To eliminate costs of import duties, brokerage fees, transportation and insurance, incurred in connection with the Convair conversion program prior to being used in transport service			-17985	-17956	-11063	-11060
4. To exclude costs of DC-9 flight equipment not used in transport operations until October 31 1966:						
(a) Flight equipment expendable parts recorded in Account 1310			-63093	-279156		-84562
(b) Flight equipment rotable parts & assemblies recorded in Account 1608			-5593	-153654		-34413
5. To exclude prepayment under a bailment agreement on DC-9 engineering equipment, not useful until October 31, 1966				-15000		-3752
TOTAL	-891452	-337997	-429292	-3930129	-1293439	-1445974
C/ To record the liability for net profit sharing refunds offset by carrier's booked estimated profit sharing as follows:						
1. 1962 - Total refund $45,563 - $21,113 tax reduction	-19450	-19450				
2. 1963 - Total refund $50,600 - $19,621 tax reduction offset by $24,103 ($52,317 - 27,914)	-6082	-6082	-6082			
3. 1964 - Total refund $352,542 - $176,246 tax reduction - offset by $46,964 ($134,172 - $40,000) booked in 1965 and reversal of $8,775 ($16,954 - $8,179) booked in the June, 1966 quarter	-14332	-14332	-99107	-86107	-86107	
4. 1965 - Total refund 774,572 - 372,879 tax reduction - offset by 144,445 ($375,000 - 180,555) booked in 1965 and $29,146 ($56,310 - $27,164) booked in the December, 1966 quarter	-207219	-207219	-207219	-207219	-122077	
TOTAL	-247083	-247083	-312408	-293326	-208184	-290494

Schedule W

Class Rate Profit Sharing Schedule - Investment - Explanatory Notes to Schedule W

Carrier: Trans-Texas Airways, Inc.

Year ended: December 31, 1966

	1/1/66	3/31/66	6/30/66	9/30/66	12/31/66	Average
D/ Per staff - See revised referenced Schedule V-1		-222	-224	-226	-229	-122
E/ As reported by carrier		-526	-16507	-16507	-45199	-14104
Per staff - See revised referenced Schedule B		-15,295	-0-	-0-	-0-	-3,824
F/ 1. To reduce investment for erroneous recording of profit on sale of FERPA to Casco Inc. and D.R. Hall - reversed by carrier in the September quarter			-5595			-1399
2. To increase investment for the airframe depreciation charged operating expenses while the CV-240's were out of service for conversion to CV-600 (See Sched C)		3900	6219	9684	13311	6363
3. To adjust for that portion of interest expensed in 1965 and capitalized in Account 1689 in 1966 (See Note B/ 2)					-38377	-4397
Total		3900	624	9684	-25066	169
G/ 1. As reported by carrier	-766174	-852679	-1281696	-1290750	-1133301	-1091215
2. To exclude equipment purchase deposits to Douglas Aircraft recorded in Account 1290					-3150000	-393756
Total	-766174	-852679	-1281696	-1290750	-4283301	-1484963
H/ To eliminate nonrein proceeds from the sale of flight equipment, recorded in the cash account		-20643	-1190	-2122		-5999
I/ As reported by carrier	-50035	-135195	-24956	-88129	-41039	-71934
Per staff - See revised referenced Schedule V-1	-59272	-135432	-29092	-89364	-51314	-73420
					-12977	-1632
J/ As reported by carrier						
1. Per 1965 profit sharing case: To reflect 1966 unused investment tax credit - applied to reduction of 1965 taxes	130015	130015	130015	130015	130015	130015
2. Per staff revised Schedule R					584757	33095
Total	130015	130015	130015	130015	714772	163110

CLASS RATE PROFIT SHARING SCHEDULE - INVESTMENT - EXPLANATORY NOTES TO SCHEDULE W

CARRIER: TRANS-TEXAS AIRWAYS INC. -- YEAR ENDED: DECEMBER 31, 1966

		1/1/66	3/31/66	6/30/66	9/30/66	12/31/66	AVERAGE
K/ To exclude net book values of 8 CV-240 airframes at date taken out of service for conversion to CV-600s:							
	N94253	-61245					
	N94246		-366714 ‖				
	N94205		-93663				
	N94265			-51987			
	N94278				-375429 ‖		
	N94279				-89027		
	N94258					-49701	
	N94223					-47152	
TOTAL		-61245	-460377	-51987	-464456	-96493	-265471

‖ Includes net book value of CV-240 and conversion cost that had been transferred from Account 1684 to CV-600 Account 1601; however, converted CV-600 had not entered transport service at end of period

W/ To eliminate investment in Magic Valley Frozen Food, Inc. This amount was written off in 1965 as a bad debt receivable from Tru-Taste Co., a bankrupt firm that was taken over in 1966 by Magic Valley, whose stock was issued in settlement to the creditors of Tru-Taste

						-810	-107

N/ 1. Per 1965 Profit Sharing Case - To increase investment for flight and ground property & equipment net depreciation adjustment resulting from the carrier's method of recomputing depreciation and erroneously depreciating certain ground property on a five in lieu of a six year life consistent with those recognized by Internal Revenue Service and in conformance with the class rate

		83481	83481	83481	83481	83481	83481

2. To reduce staff adjustment by carrier's reversing entry booked in October, 1966

						-25284	-3161

3. To increase investment for current year depreciation adjustment

						22463	2808
TOTAL		83481	83481	83481	83481	80660	83128

INVESTMENT SCHEDULE

TEXAS INTERNATIONAL AIRLINES, INC.
P. O. Box 60188 • Houston, Texas 77060 • Phone 644-3471

Roach

June 26, 1969

AIR MAIL

Mr. Harry H. Schneider, Chief
Local Service Division
Bureau of Economics
Civil Aeronautics Board
Washington, D. C. 20428

Dear Mr. Schneider:

In re B-68
1966 Class Mail Rate Profit Sharing
Dockets 16750 and 15359

This is to advise that, with the exception of the federal income taxes, Texas International accepts the Staff's numbers as reported by your letter of April 18, 1969 concerning our profit sharing for 1966.

Due to certain problems associated with the Company's acquisition in December, 1968, our accountants have been unable to complete and file the 1968 federal tax return. We are unable to prepare or accept a pro-forma tax return as the pro-forma may be different from the actual return when it is completed.

We will file the federal income tax return as quickly as it is completed.

Very truly yours,

TEXAS INTERNATIONAL AIRLINES, INC.

R. J. Sherer
R. J. Sherer
President

RJS/cb

COPY

CIVIL AERONAUTICS BOARD
Washington, D.C. 20428

November 25, 1969

Mr. Robert Sherer
President
Texas International Airlines, Inc.
Box 60188
Houston, Texas 77060

Dear Mr. Sherer:

Re: 1966 Class Rate Profit-Sharing,
Dockets 16750 and 15359

On April 18, 1969, we sent you a copy of the staff's tentative profit-sharing which indicated a refund due to the government of $320,255 and asked for your review and comments. Also, so we could complete our review of your profit-sharing for 1966, we asked for a copy of your 1968 federal tax return.

In your letter of June 26, 1969 you advised us that Texas International accepts the staff's position with the exception of the tax carryback provisions. In a letter of September 9, 1969, you sent us a copy of the 1968 tax return, together with a copy of the Application for Refund from Carryback (Form 1139), which were to be filed on September 15, 1969. The submitted forms show that the net operating loss indicated by your 1968 federal income tax return will be carried back against 1965 and 1966 taxes paid.

Review of the tax return disclosed that income used in the determination of the net operating loss included substantial amounts of non-operating income consisting of gains realized from sales of flight equipment. These gains reduced the amount of loss available for carryback.

It has been the Board's policy, in all subsidy cases, not to recognize income taxes relating to gains realized on sales of flight equipment when the gains are not used to reduce subsidy otherwise payable to a carrier. Accordingly, we have eliminated the gains from 1968 taxable income reported in Texas International's federal tax return and have increased the amount of operating loss available to carryback for offset against 1965 and 1966 taxable income. We also have adjusted 1965, 1966 and 1967 taxable income or loss, to

COPY

Mr. Robert Sherer (2)

exclude flight equipment gains reported in those years before applying the 1968 net operating loss, as adjusted. Moreover, 1968 net operating loss carryback has been decreased by the reported 1968 subsidy adjustment for 1965 profit-sharing. In contrast with the prior position, Arkansas state income taxes are recognized in toto, without the impact of the 1968 NOL carryback. We have recomputed Forms T-88 accordingly and the result of these adjustments are shown on Schedules A, R and W attached. Our revised computations indicate that a refund of $325,474 is due to the government.

We plan to finalize the foregoing promptly. If you have further objections, the staff is available to discuss this revised position. Your reply is requested within 20 days of the date of this letter.

A copy of this letter and the attached schedules, together with your written reply, if any, will be placed in the public file.

Sincerely yours,

/s/ Harold Krellen

Harold Krellen
Chief, Local Service Division
Bureau of Economics

Attachments

BEFORE THE

CIVIL AERONAUTICS BOARD

WASHINGTON, D. C.

In the Matter of TEXAS INTERNATIONAL AIRLINES, INC. (Formerly Trans-Texas Airways) LOCAL SERVICE CLASS SUBSIDY RATE	Docket Nos. 16750 and 15359

MEMORANDUM TO THE BOARD URGING THAT TEXAS INTERNATIONAL'S CLASS RATE FOR 1966 BE CLOSED

Communications with respect to this document may be sent to:

Robert J Sherer
President
Texas International Airlines, Inc.
Houston International Airport
P.O. Box 60188
Houston, Texas 77060

VERNER, LIIPFERT, BERNHARD
& MC PHERSON
Suite 1100
1660 L Street, N.W.
Washington, D. C. 20036

Of Counsel:
Jno. K. Ayer
Vice President - Legal and
Governmental Affairs
Texas International Airlines, Inc.
Houston International Airport
P.O. Box 60188
Houston, Texas 77060

Date: December 15, 1969

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penalized by a formula which the Board has recognized as overly severe in bringing about subsidy reductions. Orders E-26865, June 3, 1968; E-26986, June 27, 1968; and 69-7-6, July 1, 1969. In addition, the impact of the formula was particularly drastic in the case of Texas International, for the reason that the 91.6% growth was substantially in excess of the estimates of growth used by the Board in fashioning the formula, as well as being in excess of the average rate of growth experienced by the local service carriers as a group.

The result of the staff proposal would be manifestly unfair to Texas International. It would produce two reductions in subsidy based on the same operations in the loss year 1968. Measured by conventional standards, the company's operations reflected continuing need for additional subsidy, not cause for imposing two reductions.

2. Refusal to close the company's 1966 Class Rate without capture of the estimated NOL carryback would discriminate against Texas International to its detriment.

   a. The proposed adjustment discriminates against Texas International.

By Order No. 60-1-99 issued on January 24, 1969, the Board in determining Frontier Airlines' subsidy refund, closed its class rate for the year 1966 without consideration of any net operating loss carryback from 1968. There was no question at the time that Frontier would have NOL carryback from 1968 available to produce a refund from its 1966 income taxes. Frontier experienced operating losses in 1968 of approximately $7,250,000, which would have generated a substantial NOL carryback. Moreover, Frontier's taxable income for 1965 (the earliest year to which Frontier could carry the 1968 NOL under §172 of the Internal Revenue Code) of only $545,479 was grossly insufficient to offset the entire 1968 net operating loss.

The Board staff was aware of Frontier's NOL carryback potential in the fall and winter of 1968 since data which accompanied Frontier's Form 41 reports showed operating losses of $3,025,151 for the first eight months of 1968, $3,678,681 for the first nine months, $4,139,013 for the first ten months, and $5,326,031 for the first eleven months, respectively. Frontier's inability to make up such huge losses was obvious by late fall and certainly by the time the Board issued the order on January 24, 1969. The Board staff knew the limited extent of 1965 taxable income available for offset, as well as the amount of NOL carryback from 1967. Moreover, Frontier had raised a similar issue by challenging the use of 1967 NOL carryback to reduce 1964 tax expense claims, thereby increasing 1964 profit to share. See Frontier's Memorandum to the Board dated November 6, 1968 and Order 68-1-99, paragraph 8 under "1964 Adjustments" and paragraph 6 under "1965 Adjustments".

Thus, the Frontier order represents a conscious decision not to await the filing of a 1968 tax return and, therefore, not to use that carrier's 1968 NOL carryback to reduce its 1966 class rate. Under these circumstances leaving Texas International's 1966 class rate open in order to capture possible 1968 NOL carryback would discriminate arbitrarily against Texas International, in violation of the Administrative Procedure Act and the numerous judicial decisions proscribing arbitrary and discriminatory action by administrative agencies.

The only difference between Frontier and Texas International for purposes of this issue is that Frontier's subsidies for 1964 and 1965 remained open

prior to the order, while Texas International's rates for those years are presently closed. Order Nos. 25209 and 68-11-15. This raises the possibility that the Board's decision not to await the tax benefits of Frontier's 1968 NOL carryback represents part of a compromise made in order to achieve settlement of all three years; while Texas International presently has little to bargain away. Such a distinction would not justify the disparate treatment proposed for Texas International for the 1966 rate. Texas International has over the years made every effort to achieve final class rates as early as possible. Requiring a refund based on the tax adjustment would penalize Texas International for its past cooperation and would encourage other carriers to maintain open years as long as possible to preserve bargaining flexibility. Aside from this distinction, which should favor Texas International's position herein, neither the Frontier Order nor the public file offers any reason why Texas International should be denied the benefits of a closed rate, while Frontier has been allowed to retain any refund which might result from its 1968 NOL carryback.

It is axiomatic that carriers in the same circumstances should receive like treatment, and that failure to do so constitutes arbitrary and capricious discrimination. The courts have firmly established the principle that an agency may not grant one person or company the right to do that which it denies to another similarly situated. Barrett Line, Inc. v. U.S., 326 U.S. 179 (1945); NLRB v. Don Juan, Inc., 178 F2d 625 (2nd Cir. 1949); 185 F2d 393 (2d Cir. 1950); Mary Carter Paint Co. v. FTC, 333 F2d 654, 660

(5th Cir. 1964), (Judge Brown concurring), rev'd, 382 U.S. 46 (1965). Section 10(c) of the APA also proscribes "arbitrary" and "capricious" action and provides for judicial remedies.

One might argue that the normal course of the staff's procedures brought Texas International's 1966 profit sharing for final review later than Frontier's, and that Texas International must accept the consequences of administrative lag. However, the staff's workload does not justify such a gross difference between two carriers in the substantive disposition of the same issue. This is not merely a case where actual facts have become available at a later time, and the Board is required to apply the statutory standards to such facts. cf, Delta Chicago and Southern Mail Rate Case, 24 CAB 1. Here the staff, in applying a formula prescribed by the Board's order, is proposing as a matter of discretion to apply it one way in the case of Frontier and another way in the case of Texas International.

Texas International stands in substantially the same position as Frontier in relation to the course of the review procedure. The staff had completed both audits before either company filed a 1968 tax return and was aware that the year 1968 might produce some NOL carryback in both cases. Knowing of Frontier's 1968 losses, the staff did not have to review Frontier's 1966 profit sharing when it did. It could rationally have first reviewed the companies who claimed no Federal taxes in their 1966 profit sharing with the knowledge that their profit to share, if any, could not be affected by the

reduction of tax expense claims due to 1968 NOL carryback. These companies include Lake Central Airlines and Pacific Airlines, whose 1966 subsidies remain open at the present time. Thus, the Frontier result may not be attributed to differences in timing alone; it represents a decision in principle not to capture that company's 1968 NOL carryback.

b. The discrimination would cause detriment to Texas International

The detriment caused by the discriminatory adjustment would include the loss to Texas International of as much as $325,000 in the form of a subsidy refund. The prejudice to Texas International is not limited to the loss of funds which might result from a tax refund related to the NOL carryback. Because Texas International must first settle the amounts of the carryback and tax refund applicable to 1966, if any, with IRS, the 1966 Class Rate would have to remain open for some time. Texas International would continue to suffer the disadvantages of an open rate: the uncertainties in financial data and cash flow that impair planning, as well as the risk of further adjustments to the rate. Having the open rate for 1966 establishes a poor climate for Texas International's efforts to improve its financial posture and to diminish its reliance on subsidy. Texas International's management has been acutely aware of these disadvantages for some time, as evidenced by its effort to close the rates for prior years as soon as possible and its present desire to close 1966. The only real protection in the present situation is a Board order closing Texas International's 1966 rate on the same basis as Frontier's.

3JR

TEXAS INTERNATIONAL AIRLINES, INC.
P. O. Box 60188 • Houston, Texas 77060 • Phone 644-3471

April 6, 1970

Mr. Harold Krellen
Local Service Division
Bureau of Economics
Civil Aeronautics Board
Washington, D. C. 20428

Dear Mr. Krellen:

In re 1966 Tax Recovery

This is to advise that Texas International Airlines, Inc. has operating losses during the year 1969 sufficient to recover all taxes paid during 1966. Texas International will recover these taxes, but we do not plan to file a tax return until September.

If you need further information concerning our tax handling for the year 1966, please let us know.

Very truly yours,

TEXAS INTERNATIONAL AIRLINES, INC.

Roy M. Rawls

Roy M. Rawls
Senior Vice President, Finance

RMR/cb

cc: B. O. Wilson

COPY

April 8, 1970

AIR MAIL

Mr. W. Lloyd Lane
President
Texas International Airlines, Inc.
Box 60188
Houston, Texas 77060

Dear Mr. Lane:

Re: 1966 Class Rate Profit-Sharing,
Dockets 16750 and 15359

In accordance with Mr. Donaldson's telephone conversation with Mr. B. O. Wilson on April 3, 1970, we are forwarding revised copies of Schedules A, B, R, T and W.

Your submitted profit and loss statement for the year ended December 31, 1969 shows a net operating loss of $6,396,000. Pursuant to the Board's Order 70-3-92 dated March 18, 1970, this loss has been carried back against 1966 taxable income, resulting in zero Federal income taxes for 1966. We have recomputed the profit-sharing Forms T-88 accordingly, and the result of these adjustments is shown on the attached schedules. Our revised computations indicate that a refund of $296,792 is due to the Government.

We plan to finalize the foregoing promptly. If you have any further questions or comments, the staff is available to discuss this revised position. Your reply is requested within five days of the date of this letter.

A copy of this letter and the attached schedules, together with your written reply, if any, will be placed in the public file.

Sincerely yours,

/s/ Harold Krellen

Harold Krellen
Chief, Local Service Division
Bureau of Economics

Attachments

CAB Form T-88
(Rev. 2-67)

CLASS RATE PROFIT SHARING SCHEDULE

PROFIT SHARING COMPUTATION

Giving Effect to Carryback of 1968 & 1969 Net Operating Losses.

Carrier Texas International   Year ended December 31, 1966

	11/25/69 Final Pos. Step I	Adjustments	Revised Position Step I	Step II	Step III	Step IV
1. Income after tax, before profit sharing, per Schedule B	1,456,619	99,164	1,555,831	1,555,831	1,555,831	1,555,831
2. Percent of investment (1 ÷ 9)	13.2					
Investment						
3. Debt (Schedule W)	6,861,043	1,394	6,862,437	6,862,437	6,862,437	6,862,437
4. Convertible debentures (Schedule W)	715,759	(3)	715,756	715,756	715,756	715,756
5. Preferred equity (Schedule W)	–	–	–	–	–	–
6. Common equity (Schedule W)	2,083,806	15,764	2,099,570	2,099,570	2,099,570	2,099,570
7. Adjust. to common equity (50% of line 31)	–			(139,926)	(127,882)	(143,337)
8. Common equity, as adjusted (6 - 7)				–		
9. Investment (3 + 4 + 5 + 8)	11,160,608	17,155	11,177,763	11,037,837	11,049,879	11,034,426
Return Element 13.5%			1,508,998	1,490,107	1,439,034	1,433,975
10. Debt (5.75% X 3)	394,510	80	394,590	394,590	394,590	394,590
11. Convertible debentures (6.50% X 4)	[illegible]	–	[illegible]	[illegible]	[illegible]	[illegible]
12. Common equity (Line Adjustment % X 6)	653,409	2,522	655,931	655,931	655,931	655,931
13. Common equity (16.00% X 7)	–	–		(74,335)	(73,661)	(73,732)
14. Return element (10 + 11 + 12 + 13)	1,061,943	4,602	1,062,545	1,024,157	1,040,582	1,023,511
15. Percent of investment (14 ÷ 9)	9.52		9.52	9.22	9.44	9.22
16. Return at 11.00 per cent						
17. Return at 9.00 per cent						
18. Return at 3¢ per mile						
19. "D" return element*	1,061,943	4,602	1,062,545	1,024,157	1,040,582	1,023,511
20. Earnings deficiency (19 exceeds 1)						
Profit Sharing						
21. Profit to "D"	1,061,943	4,602	1,062,545	1,024,157	1,040,582	
22. "D" to 13.5 per cent	424,726	19,727	422,453	457,950	425,150	
23. Over 13.5 per cent		74,833	71,533	81,424	[illegible]	
24. Total	1,456,619	99,164	1,555,831	1,555,531	1,555,531	
Carrier Share						
25. Profit to "D" (100% X Line 21)	1,061,943	4,602	1,062,545	1,024,157	1,040,582	
26. "D" to 13.5% (50% X Line 22)	212,363	9,862	222,227	223,975	212,075	
27. Over 13.5% (25% X Line 23)		18,708	18,708	23,931	20,199	
28. Net profit to carrier	1,274,306	32,672	1,305,950	1,290,063	1,259,158	
Government's Share						
29. "D" to 13.5% (50% X Line 22)	212,363	9,863	222,226	223,975	212,075	
30. Over 13.5% (75% X Line 23)	–	57,625	57,625	71,793	74,508	
31. Government share before tax reduction	212,363	67,488	279,851	295,768	286,673	
32. Tax reduction** (Rcl) La. Only					139	
33. Total to be refunded					286,734	

* Higher of 14, 17 or 18, provided that the computed return (14) does not exceed an amount equivalent to 11.00 per cent of recognized investment (16).
** Show derivation of composite tax rate.

Schedule A

CAB Form 7x13
(2-57)

CLASS RATE PROFIT SHARING COMPUTATION
SUPPLEMENTARY STATEMENT

Giving Effect to Carryback of 1965 1969 Net Operating Losses

Carrier Texas International Airlines, Inc. Year ended December 31, 1966

1. Reported operating profit or loss, per Form 41		1,351,436
2. Adjustments for subsidy, per a/		
(a) Formula amount	5,344,000	
(b) Reported per Form 41	5,303,670	
Adjustment (a - b) b/		40,330
3. Adjustments per Schedule C		6,917
4. Nonoperating income per Schedule Q		91,463
5. Special income per Form 41		
6. Out-of-period class rate adjustments (explain fully)		
(a)		
(b)		
(c)		
7. Adjusted income before income taxes		1,590,746
8. Adjusted income taxes per Schedule R		5,115
9. Adjusted net income after taxes, before profit sharing		1,585,631

To facilitate the adjustment on line 12, Schedule W, the following information should be furnished:

	Quarter Ending				
	March 31	June 30	Sept. 30	Dec. 31	Total
Gross formula subsidy	1,334,000	1,334,000	1,334,000	1,342,000	5,344,000
Reported current-year subsidy	(1,325,725)	(1,325,725)	(1,325,725)	(1,326,595)	(5,303,670)
Difference-cumulative	(7,725)	0	0	6,330	6,330
Taxes (credits) cumulative	1,055			(1,241)	(186) c/
Net to line 12, Schedule W	(6,670)	0	0	5,089	6,144

a/ Before profit-sharing computation.
b/ If the Form 41 quarterly reports do not include the reconciliations of Federal Subsidy (Account 4102) on Schedule P-2 as required by Standard Practice Letter 9, revision #1, effective August 13, 1954, these quarterly reconciliations should be appended to this filing.
c/ Total should agree with the amount on line 10, Schedule R.

Schedule T

CAB Form T-60
(Rev. 2-57)

CLASS RATE PROFIT SHARING SCHEDULE
INCOME TAX ADJUSTMENT - SUMMARY

Giving Effect to Carryback of 1968 & 1969 Net Operating Losses

Carrier: Texas International Airlines Inc. Year ended December 31 1971

	Federal	State	Total
I. Income Tax Adjustment:			
1. Taxes per return ~~(before investment credit)~~	-0- <7)	$ 536 <1)	$ 536
2. Taxes (credits) applicable to difference between gross formula subsidy and current-year subsidy reported on tax returns b/	0	246 <R-1)	246
3. Sub-total	-0-	$ 5608	$ 5608
Adjustments:			
4. Taxes applicable to capital gains on flight equipment. See Schedule R-1		<493)	<493)
5. Taxes applicable to non-transport ventures. See Schedule S		-	
6. Taxes applicable to out-of-period subsidy and other income not otherwise considered for profit-sharing. See Schedule U			
7. Credits (taxes) applicable to profit sharing of prior years, if included on line 1. See Schedule U c/			
8. Adjusted taxes to Schedule B		$ 5115	$ 5115
II. Investment Adjustment as at December 31			
9. Taxes as reported in Accounts 9191.1 and 8185, Form 41		-	$ 709814
10. Taxes (credits) applicable to cumulative difference between gross formula subsidy and current-year subsidy as reported on Form 41, if not included on line 9			256
11. Adjusted taxes (line 8 + 10)			710070
12. Difference line 11 over line 3 (to line 23, Schedule W)			704462

a/ As indicated below provide a breakdown of the gross receipts as reported on the Federal tax return and reconcile with the operating revenues as reported on Form 41.

	Tax Return	Form 41	Difference*
	$	$	$
Passenger & excess baggage	70149815	70149815	
Property	1151779	1151779	
Charters	446108	446108	
Incidental and other	335709	335709	44036
Federal subsidy	5303670	5303670	
Total	$77384980	$77384980	$44036

*Submit detailed explanation.

b/ Gross formula subsidy ..... $ 5344000
Current-year subsidy 5303670
Difference ..... $ 40330

c/ Credits must not exceed the tax reduction previously reflected in the profit-sharing determination. Submit a reconciliation.

NOTE: Show derivation of taxes and/or credits as claimed on lines 2 and 10.

<1) Per State tax returns filed:

Arkansas	$ 255
Louisiana	267
Mississippi	14
New Mexico (NOL applied)	0
Total	$ 536

Schedule R

BRIEF OF PETITIONER TEXAS INTERNATIONAL AIRLINES, INC.

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

TEXAS INTERNATIONAL AIRLINES, INC., Petitioner	:	
v.	:	No. 24,459
CIVIL AERONAUTICS BOARD, Respondent	:	

On Petition for Review of an Order of the Civil Aeronautics Board

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* Cases or authorities chiefly relied upon are marked by asterisks.

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

TEXAS INTERNATIONAL AIRLINES, INC. Petitioner v. CIVIL AERONAUTICS BOARD Respondent	No. 24,459

BRIEF OF PETITIONER TEXAS INTERNATIONAL AIRLINES, INC.

STATEMENT OF THE ISSUE

It is undisputed that the Civil Aeronautics Board, in the administration of its local service carrier subsidy program, granted certain carriers an allowance for income taxes for 1966 which it denied Texas International Airlines, Inc. The issue is whether this discrimination against Texas International is arbitrary, capricious, an abuse of discretion, contrary to the requirements of due process or otherwise not in accordance with law and should be set aside pursuant to Section 10(e) of the Administrative Procedure Act, 5 U.S.C. § 706.

This case has not previously been before this Court.

REFERENCES TO RULINGS

The ruling of the Civil Aeronautics Board on review is CAB Order 70-5-108, dated May 21, 1970 (J.A. 27), which in turn relies expressly upon the opinion of the Board contained in its Order 70-3-92, dated March 18, 1970 (J.A. 13).

STATEMENT OF THE CASE

Under the authority vested in it by Section 406 of the Federal Aviation Act of 1958 (49 U.S.C. § 1376) [1/] the Civil Aeronautics Board (herein the Board) fixes subsidy mail rates for that class of air carriers known as the local service carriers. [2/] These rates include amounts of subsidy intended to assist those carriers in maintaining air transportation services to points which could not economically otherwise sustain such services. The issue in this case arises out of the Board's administration of the subsidy program.

1/ This statute requires the Board to take into account in fixing "mail rates" which comprise a subsidy element,

> "the need of each such air carrier ... for compensation ... sufficient to insure the performance of [mail] service, and, together with all other revenue of the air carrier, to enable such air carrier under honest, economical, and efficient management, to maintain and continue the development of air transportation to the extent and of the character and quality required for the commerce of the United States, the Postal Service, and the national defense ...."
> 49 U.S.C. § 1376.

2/ The local service carriers presently are Air West, Allegheny, Frontier, Mohawk, North Central, Ozark, Piedmont, Southern and Texas International.

A. General Background.

Since 1961 the Board has, for administrative convenience, performed its obligations under Section 406 by prescribing a single "class rate," a formula for determining the subsidy payable to all of the air carriers classified as local service carriers. Local Service Class Subsidy Rate Investigation, 34 C.A.B. 416, 428 (1961). From time to time the formula embodied in the class rate has been modified in the light of experience. The successive class rates were numbered Class Rates I, II, III, etc.

The dispute here involves an order of the Board directing the refund to it of subsidy paid to Texas International Airlines, Inc. [3/] for operations during calendar year 1966. The applicable class rate is Class Rate III-A, promulgated in CAB Order E-23850, June 23, 1966. The formula embodied in Class Rate III-A contained a provision for review by the Board of the subsidy paid each local service carrier after the fact in the light of its operating results for the year in question, and for "profit-sharing" with the Government (that is, a refund to the Government of a portion of the subsidy already paid the carrier for that year) if profits were in excess of those needed to provide the allowed return on investment. In determining whether there was any profit to share, the Board allowed, as though it were an expense, the income tax actually paid by the carrier on its income

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3/ Formerly known as Trans-Texas Airways, Inc.

for the year under review. 4/

In 1966 the local service carrier industry earned an aggregate net profit before taxes of $17,050,000, paid income taxes of $6,558,000, and had a net income after the payment of such taxes and certain other special items of $10,376,000. 5/ This was sufficient that almost all the local service carriers were therefore subject to refund to the Board a part of the subsidy paid them in 1966 in an amount to be determined by the Board after reviewing the results of 1966 as reported by the carriers. Final determination by the Board of the amounts of such refunds due for 1966 were, in fact, made in 1969 and 1970 with respect to the different carriers. See p. 8, infra.

By this time the local service carriers were incurring substantial losses. A number of factors contributed to this, not the least

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4/ The formula provided, in pertinent part, as follows:

> "Federal and State income taxes shall be determined on the basis of the carrier's actual income taxes, including the reduction of taxes resulting from loss carrybacks and carryovers, as reported on its income tax returns submitted to taxing authorities for each year, with such amendments and revisions as may have been filed as of the final determination or profit-sharing hereunder; Provided, however, that, for the purposes of this order, the carrier's actual income taxes for a given review year will be adjusted to exclude taxes related to income which is not otherwise considered in the profit-sharing determination, hereunder, for that review year; Provided, further, that where a final profit-sharing determination for a prior period has been made and the tax basis relied upon in that final determination has been amended or revised subsequently, the effect of the change in taxes will be considered as income or expense for profit-sharing purposes in the year in which the change is made ...." Order E-23850, June 23, 1966, p. 22.

5/ CAB Air Carrier Financial Statistics, 1966.

significant of which was the Board's adoption of a new subsidy formula embodied in Class Rate IV effective January 1, 1967. Order E-25231, June 1, 1967. Class Rate IV eliminated all provision for profit-sharing as related to the carrier's profit or loss on its actual operating results. It substituted a provision for a reduction in the amount of the subsidy paid each carrier by an amount equal to a prescribed percentage of the growth in that carrier's passenger revenues when compared to a specified historical period regardless of the profit or loss nature of the carrier's operating results. Thus, even if a loss were incurred despite increased revenues, that loss would be further aggravated by reducing the amount of the federal subsidy paid the carrier for that year by a percentage of its increase in passenger revenue. This is, in fact, what did happen to every carrier in the local service industry in at least one or more years in the period 1967-1969.

The combined results for all of the local service carriers during the years 1965-1969 were as follows:

All Local Service Carriers

Year	Subsidy Received (000)	Operating Profit or (Loss) (000)	Net Income or (Loss)* (000)
1965	$ 66,001	$ 24,023	$ 12,722
1966	54,924	23,467	10,376
1967	50,961	691	(4,312)
1968	40,950	(9,210)	(29,800)
1969	35,981	(16,060)	(62,858)

Source: Table 1, CAB Air Carrier Financial Statistics, 1965-1969.

*Operating profit is before provision for interest, income taxes and special items. Net income is after provision for all such items.

Texas International's results, as officially reported to the CAB for the years 1965 through 1969, were as follows:

Texas International Airlines, Inc.

Year	Subsidy Received (000)	Operating Profit or (Loss) (000)	Net Income or (Loss)* (000)
1965	$ 5,842	$ 1,267	$ 595
1966	5,304	1,398	991
1967	4,211	507	(378)
1968	3,705	54	(1,483)
1969	3,331	(3,574)	(5,090)

Source: CAB Form 41 Reports.

* Operating profit and net income computed as in preceding table.

The results for Frontier Airlines, Inc., the relevance of which is explained at pages 12-13 infra, were comparable:

Frontier Airlines, Inc.

Year	Subsidy Received (000)	Operating Profit or (Loss) (000)	Net Income or (Loss)* (000)
1965	$ 6,913	$ 2,985	$ 1,313
1966	5,129	3,538	1,790
1967	5,434	1,306	(121)
1968	5,889	(3,583)	(6,811)
1969	6,730	475	(12,214)

Source: CAB Form 41 Reports.

* Operating profit and net income computed as in preceding table.

B. Procedure for Determining Profit-Sharing Under Class Rate III-A.

The procedure established by the Board required each local service carrier to file with the CAB, within 120 days after the end of the year

under review, a set of reports identified as Form T-88. These reports disclosed the results of the carriers' operations for the year in question and made certain computations regarding the allowable investment and rate of return, and resulted in a declaration by each carrier whether, according to its computations, there was any profit to share or a subsidy deficiency. 6/

Following the filing of each carrier's Form T-88, the Board staff conducted a field audit of the carrier's accounts to determine whether the expenses as reported conformed to certain Board standards regarding what was allowable, adjusted the carrier's Form T-88 to reflect the staff's findings, and notified the carrier that it could settle its profit-sharing obligation, assuming the computation called for a refund, for the year in question by agreeing to the repayment of the adjusted amount. If the carrier agreed, a Board order was then issued formalizing the agreement. Usually such an order was issued by the Board's staff pursuant to delegated authority. If the Board staff determined that there was a deficiency rather than a profit to share, the carrier was so notified by letter from the staff and that was the end of the matter.

This process of settling the amount, if any, of profit to share

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6/ Under Class Rate III-A, a "deficiency" existed when the carrier's earnings were, even after taking into account the subsidy received, insufficient to provide it with the return to which the Board had declared it entitled. Even though a deficiency existed, there was no provision for increasing the subsidy payable to the carrier to make up for it.

ordinarily ran at least well into the second year following the year under review, and frequently took much longer. The Board closed out 1966 subsidy for the various local service carriers, either by issuance of an order claiming a refund, or by a notification of a subsidy deficiency, on the following dates:

Carrier	Date	CAB Order
North Central Airlines, Inc.	January 15, 1969	69-1-62
Frontier Airlines, Inc.	January 24, 1969	69-1-99
Southern Airways, Inc.	March 20, 1969	69-3-75
Mohawk Airlines, Inc.	October 2, 1969	Deficiency Letter
Texas International Airlines, Inc.	May 21, 1970	70-5-108
Ozark Air Lines, Inc.	May 21, 1970	70-5-107
Allegheny Airlines, Inc.	June 1, 1970	70-6-9
Hughes Air West	July 15, 1970	70-7-73 70-7-74
Piedmont Aviation, Inc.	Not yet settled	

C. Texas International's Profit-Sharing for 1966.

Texas International duly filed its Form T-88 for the year 1966 with the Board on April 19, 1967. As filed, Texas International's Form T-88 reported a subsidy deficiency of $232,710. The Board staff conducted its field audit at the company's offices in August and September 1967 and this was followed by discussions between the carrier's representatives and the Board's staff regarding the audit findings and adjustments in the carrier's figures as reported. On

January 22, 1968 the Board's Bureau of Accounts and Statistics wrote Texas International informing it that the field audit, if all the Board's adjustments were accepted, had the net effect of reducing the 1966 subsidy deficiency from the $232,710 reported by the company (J.A. 33) to approximately $159,000 -- but still a subsidy deficiency (J.A. 37). There was therefore no profit-sharing refund required of Texas International. Following receipt of that letter, on February 1, 1968 Texas International wrote the Board's audit staff accepting the recommendations in the January 22 letter (J.A. 43). In the meantime, the Board's Bureau of Accounts and Statistics had forwarded its audit findings to the Board's Bureau of Economics for consideration and processing of Texas International's Form T-88 for 1966. Letter of January 22, 1968, supra (J.A. 37).

Some 15 months later, on April 18, 1969, the Board's Bureau of Economics advised Texas International by letter that they had reviewed the Form T-88 and had tentatively determined that a refund of $320,255 was required, as compared with the subsidy deficiencies computed by the company and the Bureau of Accounts and Statistics (J.A. 59). The chief difference accounting for the Bureau of Economics claim that there was profit to share was its treatment of income taxes. It proposed to recapture an amount based on a tax credit available to Texas International from the carryback against 1966 income taxes of the net operating loss Texas International had incurred in 1968. The Bureau of Economics letter requested a copy of Texas International's 1968 Federal

tax return, or if that was not yet available, a pro forma return. In fact no return had yet been filed by Texas International for 1968 and no claim for refund of 1966 taxes had been made. The Board had no claim for a profit-sharing refund except for the tax carryback adjustment. The legality of this refund claim is the subject of this appeal.

On June 26, 1969 Texas International by letter advised the Bureau of Economics that, except as to the tax carryback adjustment, it accepted the Bureau's revision of the carrier's Form T-88 (J.A. 80). In September 1969 Texas International filed with the Internal Revenue Service its Federal income tax return for 1968 showing a pretax loss of $1,722,067. It filed concurrently an application for refund from the carryback of a net operating loss or unused investment tax credit totaling $1,714,808, of which $532,106 was applicable to taxes paid in 1966 and the remainder to 1965 under the requirements of the Internal Revenue Code. Copies of these returns were furnished the Bureau of Economics.

On November 25, 1969 the Bureau wrote Texas International referring to the foregoing tax returns, again revising Texas International's Form T-88, to claim a further refund (J.A. 81), but this further revision was ultimately rejected by the Board and is not in issue here. As recomputed in this letter the Form T-88 showed a refund due of $325,474.

By letter dated December 8, 1969 Texas International responded to the Bureau, objecting to any claim based on a carryback of the 1968

net operating loss, and on December 15, 1969 Texas International filed a formal Memorandum directed to the Board itself urging that Texas International's class rate for 1966 be closed without a refund (J.A. 83).

On March 4, 1970 the Board afforded Texas International and three other local service carriers against which the Board staff was also pressing a claim for refund based on tax carryback of net operating losses (Allegheny Airlines, Air West and Ozark Air Lines) the opportunity to make an oral presentation to the Board members on the issues involved in the 1966 profit-sharing computation. By this time the staff was asserting 1966 subsidy refund claims based on carryback of the carriers' 1969 net operating losses as well.

On March 18, 1970 the Board issued its opinion upholding the Bureau's position on the carryback of both 1968 and 1969 net operating losses for the purposes of computing subsidy refunds under Class Rate III-A as to these four carriers. Order 70-3-92 (J.A. 13). The opinion did not, however, order any action.

Following the issuance of the above opinion and in reliance on it, the Board on May 21, 1970 issued its Order 70-5-108 (J.A. 27) directing Texas International to refund $296,792 of the 1966 subsidy paid it. This was a newly recomputed figure, attributable entirely to the income tax carrybacks. Other adjustments had been deleted, but the deletion was largely replaced by including in the subsidy refund now asserted to be due the taxes recoverable because of the 1969 net

operating loss of Texas International, although at the time of the order Texas International had not filed its Federal tax return for 1969 or made any claim for refund of the 1966 taxes due to a carryback to that year of 1969 net operating loss. Of the total amount, approximately $96,000 is attributable to the carryback of the 1968 net operating loss and approximately $200,000 is attributable to the anticipated carryback of the 1969 net operating loss.

D. Other Carriers' Profit-Sharing for 1966.

Before it assessed the subsidy refund based on net operating loss carrybacks against Texas International, the Board had disposed of 1966 subsidy matters for four other local service carriers -- Frontier, North Central, Southern and Mohawk (see p. 8, supra). None of these carriers had had a claim for subsidy refund assessed against it based on the carryback of 1968 or 1969 net operating losses. It appears that North Central, Southern and Mohawk did not have 1966 tax refund claims based on 1968 net operating losses. These carriers' 1966 subsidy rates were closed out before it could be determined whether they would be entitled to 1966 tax refunds for 1969 net operating losses. Frontier did have a 1968 net operating loss tax refund against 1966 taxes.

Frontier, like Texas International, filed its Form T-88 for 1966 with the Board in April 1967. There followed the usual field audit and discussions between the carrier's representatives and the Board's Bureau of Economics regarding adjustments in the figures as reported. Frontier had profits and paid income taxes in 1966, and experienced

losses in the years subsequent to 1966. See p. 6, supra. The period of discussion and negotiation between it and the Bureau of Economics regarding proposed adjustments in its reported figures extended throughout the year 1968. On November 6, 1968, in connection with review of its profit-sharing, Frontier filed a Memorandum with the Board which called attention to its 1968 net operating losses (J.A. 47,49). On November 8, 1968 Frontier filed with the Board its Form 41 (a quarterly report required by the Board) showing, among other things, its operating results for the 12 months ending September 30, 1968 (J.A. 55,56). This showed a cumulative net loss before taxes of $6,267,720 and provision for an income tax credit of $2,385,605. 7/ The Board settled Frontier's profit-sharing for 1966 on January 24, 1969 without any provision for or reference to tax carryback refunds for 1966 taxes attributable to the net operating loss from 1968. Order 69-1-99 (J.A. 1). While this order required a refund by Frontier of $787,195, no part of this refund was attributable to any net operating loss carryback from 1968.

Texas International filed this appeal on July 20, 1970. The other three carriers against which the Board has asserted subsidy refund claims based on the carryback of 1968 and 1969 net operating losses have also noted appeals -- Allegheny in the Fourth Circuit (No. 14892,

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7/ Frontier's Form 41 report to the Board for calendar 1968, filed March 31, 1969, reported a net operating loss for 1968 of $8,676,745 and a tax credit of $1,865,641.

filed July 22, 1970), Ozark in the Eighth Circuit (No. 20543, filed September 14, 1970), and Air West in the Ninth Circuit (Nos. 26411, 26412, filed September 10, 1970).

SUMMARY OF ARGUMENT

It is undisputed that the Civil Aeronautics Board required Texas International to refund to it subsidy payments Texas International had received for calendar year 1966, on the ground that Texas International had received or would receive Federal income tax refunds of 1966 taxes as a result of the carryback of 1968 and 1969 net operating losses, while the Board allowed other subsidized carriers to keep identical Federal tax refunds. This was plain discrimination against Texas International, and contrary to the most fundamental legal principles. Such discrimination is arbitrary and capricious within the meaning of the Administrative Procedure Act, and violates due process of law, and as such must be set aside.

The Board defended its discrimination below by claiming it to be a necessary result of the Board's procedures in the application of an "actual tax" policy. These procedures involved reviewing the 1966 results of the various local service carriers seriatim. The Board closed out the 1966 results for the first carriers whose subsidy it processed without any tax adjustment, and then made the tax adjustment refund claim as to later carriers. The Board could have provided a fair result either by giving the later carriers it processed the same treatment as the earlier carriers, or it could have provided an alternative

fair result by holding open the income tax aspects of subsidy processing for all carriers and settling the tax situation for all carriers at the same time. Either procedure would have been proper and would have avoided the unjust result the Board reached. Having decided to allow the earlier processed carriers to keep the tax refunds, however, the Board must provide the same treatment for all carriers similarly situated.

Furthermore, the Board did not in fact apply an "actual tax" policy consistently. As to some carriers it relied upon actual taxes paid at the time subsidy was closed out, but as to others, including Texas International, the Board looked forward to recapture tax refunds which had not even been applied for. This course of action was also arbitrary and discriminatory.

ARGUMENT

THE ORDER OF THE CIVIL AERONAUTICS BOARD REQUIRING TEXAS INTERNATIONAL TO REFUND SUBSIDY WHICH OTHER CARRIERS IN IDENTICAL CIRCUMSTANCES WERE ALLOWED TO KEEP DISCRIMINATED AGAINST TEXAS INTERNATIONAL AND WAS ARBITRARY AND CAPRICIOUS AND MUST BE SET ASIDE.

The legal point here is simply that "It will not do to decide the same question one way between one set of litigants and the opposite way between another." 8/ That is what the Civil Aeronautics Board has done here, and this action is clearly, within the terms of Section 10(e) of the Administrative Procedure Act, 5 U.S.C. § 706, "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law," as well as inconsistent with the requirements of due process of law, U.S. Const., Amend. 5, and under the terms of Section 10(e) this action must be held unlawful and set aside.

1. The Board Discriminated Against Texas International.

It is undisputed that the Board discriminated against Texas International in demanding recapture of income tax refunds for 1968 and 1969 net operating losses that it had not demanded from other carriers. The Board's opinion below concedes as much. Order 70-3-92, pp. 10-12 (J.A. 23-25).

As is outlined in detail in the Statement of the Case, during 1967 and 1968 the Board conducted its review of the revenues and expenses of the respective local service carriers to determine whether any refund of the subsidy paid them in 1966 was due under the applicable formula. As is also there explained in more detail, one of the

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8/ Cardozo, The Nature of the Judicial Process 33 (1921).

elements which was considered was the allowance under the 1966 subsidy formula for Federal income taxes. The local service carriers had profits during 1966, but by 1968 all of them were sustaining substantial losses. (One reason was that the new and completely different class rate formula which went into effect at the beginning of 1967 had significantly reduced subsidy.) These losses were reported to the Board and the Board was certainly aware before the end of 1968 that the carriers would be filing Federal income tax carryback refund claims for 1968 and that these would result in the refund to the carriers of 1966 taxes. See, e.g., CAB Forms 41 for period ending September 30, 1968 for Frontier and Texas International (J.A. 55, 44), Memorandum of Frontier to CAB dated November 6, 1968, pp. 1-2 (J.A. 48-49).

With this knowledge, the Board completed its review of 1966 subsidy as to some carriers and closed out their 1966 subsidy without making any downward adjustment in the subsidy tax allowance for 1966 because of these prospective refunds. Specifically, the Board did this as to Frontier Airlines, Inc. in Order 69-1-99, dated January 24, 1969 (J.A. 1). Similarly, the Board closed out 1966 subsidy for North Central, Southern and Mohawk during 1969 without regard to the possibility of 1969 net operating losses (which all these carriers in fact had) and probable 1966 income tax refunds resulting therefrom.

Frontier's case is a dramatic example of the disparity of treatment. At the time Frontier's 1966 subsidy was closed out, it had reported to the Board a 1968 operating loss of about $5,400,000. Frontier CAB

Form 41 Reports, see e.g. Report dated November 8, 1968 (J.A. 55, 56).[9/] Frontier expressly advised the Board in the proceedings which reviewed its 1966 subsidy that it would have a 1968 net operating loss. Memorandum of Frontier dated November 6, 1968, pp. 1-2 (J.A. 48-49). Frontier thus was allowed to keep the subsidy it had received for 1966 taxes despite the fact that it would be collecting refund claims, and that the Board knew or should have known that Frontier would be collecting refund claims. The Board's decision not to ask for a refund of subsidy for the 1966 tax allowance paid to Frontier must have been intentional.

When the Board came to review the subsidy of Texas International, however, it applied a different policy. On April 18, 1969, less than three months after Frontier's subsidy was closed out, the Board staff told Texas International that it would have to refund subsidy in the amount of the 1966 taxes which would be recovered by refund claims due to its 1968 losses. Letter of April 18, 1969 (J.A. 59). Texas International vigorously contested this abrupt change of policy, both as a matter of policy and because of the unjustified discrimination involved in assessing this liability against Texas International when it had not been assessed against other carriers (J.A. 83-88). Nevertheless, the Board has ordered Texas International to refund $296,792 of subsidy which it received for calendar year 1966 because of the Board's claim that this should be offset by anticipated Federal income tax

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9/ The full year's loss ultimately turned out to be over $8,600,000. See footnote 7, supra.

refunds for 1968 and 1969 operating losses. Order 70-5-108, dated May 21, 1970 (J.A. 27); Order 70-3-92, dated March 18, 1970 (J.A. 13).

The circumstances of the respective carriers were exactly the same. Thus the Board has decided the question of 1968 carrybacks one way for Frontier and decided it the opposite way for Texas International, to the obvious prejudice of Texas International. At the same time the Board has disregarded 1969 carrybacks for Frontier, North Central, Mohawk and Southern, but charged a 1969 carryback against Texas International. This is pure, arbitrary discrimination, and it cannot be allowed to stand.

2. Such Discrimination Must Be Set Aside.

That such discrimination between one party and another in the same circumstances is unacceptable is so fundamental that it has found its most concise statement in commentary rather than in cases. Thus, it was off the bench that Judge Prettyman said

> "Agency heads can change their minds, but they cannot willy-nilly treat one person in one way and another in a different way." 10/

Mr. Justice Cardozo's view of the subject has already been quoted. And it was in his lectures on the need for the development of administrative standards that Judge Friendly, pointing out that Cardozo's statement applies to administrative agencies, set out as his first reason for the need for administrative standards "the basic human claim that the

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10/ Prettyman, The Nature of Administrative Law, 44 Va. L.Rev. 685, 691 (1958).

law should provide like treatment under like circumstances." 11/

The courts have only rarely had to deal with cases of such discriminatory decision-making, and particularly rarely with situations like the one here, involving discrimination between parties in the same proceeding. When they have, they have naturally found that the administrative agency decision required reversal.

A principal case is West Ohio Gas Co. v. Public Utilities Comm'n, 294 U.S. 63 (1935). In that case the Commission was allocating gas distribution costs for ratemaking purposes. To determine the distribution costs for the City of Lima, the Commission computed the costs for the entire surrounding area, determined the per customer amount, and applied that to the customers in Lima. In the same decision, the Commission fixed the rates for the City of Kenton, which was within the area surrounding Lima. As Mr. Justice Cardozo related the circumstances:

> "In Kenton, unlike Lima, a spread of distribution costs over the whole area of service would have been favorable to the appellant and unfavorable to customers. Strange to say the commission, though prescribing the larger area for Lima, adopted the smaller one for Kenton, and this by decision rendered the same day." 294 U.S. at 71.

As the court held, "An injustice so obvious may not be suffered to prevail." (Id.) The court did not determine whether one method or the other was correct. The point was that the use of one costing method in one place and the opposite costing method in another,

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11/ Friendly, The Federal Administrative Agencies: The Need for Better Definition of Standards, 75 Harv. L.Rev. 863, 878 (1962).

without distinction as to the circumstances, was an improper and arbitrary act. The Board's cost allowance switch here stands up no better.

A similar case of administrative inconsistency rejected by the Supreme Court is Chicago, R.I. & P.Ry. v. United States, 284 U.S. 80 (1931). There the ICC had undertaken an investigation of the proper compensation for railroads for the use of their cars on other lines, and concluded that all common-carrier railroads were entitled to receive reasonable compensation for such use. The ICC also determined a reasonable charge, but at the same time it issued an order exempting certain short-line railroads from paying the compensation. The court pointed out on review that this exemption of the short-line railroads meant that other railroads would not receive the compensation which the ICC had found was required by law, and that the exemption of the short-line carriers therefore flatly contradicted the Commission's own finding. The court said:

> "The use of railroad property is subject to public regulation, but a regulation which is so arbitrary and unreasonable as to become an infringement upon the right of ownership constitutes a violation of the due process of law clause of the 5th Amendment ... and certainly a regulation permitting the free use of property in the face of an expressed finding that the owner is entitled to compensation for such use cannot be regarded otherwise than as arbitrary and unreasonable." 284 U.S. at 97.

The court set aside that part of the order of the ICC.

Comparable problems have arisen under the Administrative Procedure Act. In City of Lawrence v. CAB, 343 F.2d 583 (1st Cir. 1965), the

Civil Aeronautics Board permitted, among other things, the withdrawal of service from the New Haven Airport and the provision of service to New Haven through the existing Bridgeport Airport. The court found the Board's findings unsupported in many respects and pointed out several factual inconsistencies in the decision which required reversal. The court went on to say

> "Apart from these internal inconsistencies, the Board's decision, without explanation, reverses an earlier case involving essentially the same questions [citation]; departs from the reasoning and holding in other regional airport cases [citations]; and is inconsistent with other aspects of this same proceeding .... Such action is arbitrary and capricious, and must be reversed." 343 F.2d at 588.

The preceding three cases are alike in that the agency discriminated between the parties in a single proceeding. More frequent are cases in which the agency has discriminated by providing different treatment in different proceedings to parties who were comparably situated. These decisions demonstrate a fortiori that discrimination between parties on a single set of facts, such as is involved here, is arbitrary and capricious.

For example, in FTC v. Crowther, ___ U.S. App. D.C. ___, 430 F.2d 510 (1970), this Court remanded a case to the Federal Trade Commission "[b]ecause we think the Commission has failed to come to grips adequately with the claim of discriminatory treatment." In that case the Commission was attempting to enforce a subpoena and the defendant was resisting because the Commission refused to follow procedures for

the protection of confidential competitive data to be supplied under the subpoena which the Commission had employed in a directly comparable case two years before. The court found that such a deviation activated its duty under the Administrative Procedure Act to examine agency action to see that it was not arbitrary or capricious. Recognizing that instances of inconsistency with prior decisions necessarily involve questions of the application of stare decisis to administrative agencies, and the need to accord the agency "wide latitude in adjusting its regulatory policies from case to case," the court held that even so, these policies do not "dispense with the necessity of adequate explication of the reasons why such alteration or adaptation may be seen to be rational and to escape the domain of the seemingly arbitrary." ____ U.S. App. D.C. at ____, 430 F.2d at 514. Thus it set aside the agency action and remanded to the Commission.

Another instance is Boston and Maine R.R. v. United States, 202 F.Supp. 830 (D. Mass. 1962), aff'd by an equally divided Court 373 U.S. 372 (1963), in which the Court found that the ICC's determination of the unlawfulness of a rate rested on a single subsidiary finding which, in the light of the ICC's decisions in prior cases, was in its application to that case alone "arbitrary and capricious". 202 F.Supp. at 837.

Such cases, vacating agency decisions which are discriminatory when measured against other decisions in other cases at earlier times, confirm that the discrimination between subsidized air carriers on a

single set of facts at issue here must be set aside. See also Secretary of Agriculture v. United States, 347 U.S. 645 (1954); Barrett Line, Inc. v. United States, 326 U.S. 179 (1945); Herbert Harvey, Inc. v. NLRB, 128 U.S. App. D.C. 162, 385 F.2d 684 (1967); and T. I. McCormack Trucking Co. v. United States, 251 F.Supp. 526 (D. N.J. 1966).

3. The Board's Attempts to Justify the Discrimination Are Irrelevant and Erroneous.

In memoranda and oral arguments to the Civil Aeronautics Board, Texas International and other affected carriers pointed out the discrimination in the Board's proposal to charge them for tax carryback refunds on 1966 subsidy when it had not charged other carriers. Memorandum of Texas International dated December 15, 1969, pp. 12-16 (J.A.84-88), Tr. of Oral Argument, March 4, 1970. The Board responded to this by admitting the discrimination and attempting to justify it. Order 70-3-92, dated March 18, 1970, pp. 10-12 (J.A. 23-25).

The Board's effort at justification appears to include three arguments: (1) the Board contends that the discrimination was accidental and a necessary result of the Board's procedures, (2) the Board contends that it is consistently applying an "actual tax policy", and (3) the Board contends that if it did not discriminate against Texas International, Texas International would receive "an excessive tax allowance". Each of these contentions is contrary to the facts, and all of them are meaningless in the light of the single critical fact that the Board knew when it closed the rate for Frontier

that it would be permitting it to keep a tax carryback refund against 1966 income taxes without any commensurate subsidy reduction, and knew when it closed the rates for North Central, Mohawk and Southern that it might be doing so. The Board intentionally provided these carriers with this treatment in the administration of its subsidy program.

Thus, to take the last of the Board's arguments first, it ill suits the Board to say now that what it found was fair for Frontier is "excessive" for Texas International. The contention underscores, rather than alleviates, the discrimination. By the same token, the Board's first argument, that its procedures require the discrimination, ignores what it actually did. The Board knew that it was allowing the first carriers whose subsidy rates it closed to keep any 1968 carryback tax refunds without a charge against 1966 subsidy, and the Board knew that the carriers whose 1966 subsidy would be reviewed later would be filing for similar tax refunds. Similarly the Board knew that in closing out these carriers in early 1969 it was ignoring any further tax adjustments for results in that calendar year. The Board had two easy ways to treat all carriers alike, without any administrative inconvenience whatsoever: it could have treated the earlier carriers exactly as it did and given the later carriers fair, equal and commensurate treatment as to their tax refunds, avoiding all discrimination, or it could have decided to follow an opposite policy as to all carriers and charged the tax carryback refunds for all of them against subsidy, by keeping the rates for the earlier carriers open as to this issue

as long as it kept the rates for the later carriers open. Either course was within the Board's authority, and either course would, as between the carriers, have been fair. Instead, what the Board did was to give subsidy to some carriers and penalize others, in a completely inequitable manner. The Board says that it "would be totally infeasible to attempt to hold open each case until all possibility of amendment to the carriers' tax returns for that year had passed," Order 70-3-92, p. 10 (J.A. 23), but this is completely irrelevant. No one contends that the Board should do this, but only that the Board should treat all carriers evenhandedly. The point is that the Board is not empowered, by the need for reviewing the rates for several carriers, to grant one carrier subsidy and deny it to another on the basis of the time when it closes out the rate. This is a completely different proposition than some imaginary contention that the carriers are seeking that the rates be kept open for tax purposes forever.

Further, on this point, the Board says "there is no claim that the Board or its staff has acted in an arbitrary fashion in the order in which the cases have been processed ...." Order 70-3-92, p. 11 (J.A. 24). If by this the Board meant that there is no claim of bias in its selection of the order in which it processed the carriers' rates, it is correct, but certainly this procedure was arbitrary. It makes no difference why some carriers were processed so that they received the subsidy and some carriers were processed so that they did not. The point is the disparity in treatment, rather than the cause of the disparity.

Finally, as to the Board's other argument that it is applying "an actual tax policy" to all carriers, the Board misstates the position, for it did not follow an "actual tax policy". As to Frontier, the Board knew that there were losses which would be subject of carryback refunds, but the Board did nothing to look forward to them. The Board made a conscious decision to allow Frontier to keep the tax refund. When it came to Texas International three months later, however, the Board's staff did not claim a subsidy refund on the basis of Texas International's actual tax returns on file, but instead in April 1969 looked ahead to 1968 tax returns which Texas International would file in September 1969, 12/ and while Texas International's 1966 subsidy was still on review in March 1970, the Board itself looked ahead to 1969 tax returns which the carrier did not file until September 1970. The Board then relied on its knowledge of 1969 losses for Texas International, and demanded a refund of subsidy on account of a tax refund for which Texas International had not yet applied (much less received). The Board thus applied a principle of future recapture to Texas International that it consciously did not apply to Frontier, and applied an actual tax policy to Frontier that it refused to apply to Texas International. This doubles the discrimination, instead of justifying it.

Thus each of the Board's rationales for its discrimination is inapplicable. The Board has failed, in this instance, for whatever reason, its lawful obligation to provide the parties before it with

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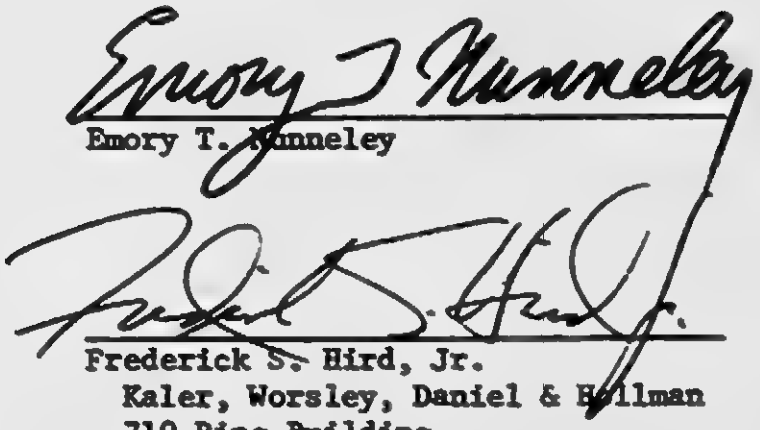
12/ Pursuant to Section 6081 of the Internal Revenue Code, 26 U.S.C. § 6081.

evenhanded treatment. The Board's abrogation of this fundamental principle is erroneous, arbitrary, capricious and unjust, and must be set aside.

CONCLUSION

For the foregoing reasons, Order 70-5-108 of the Civil Aeronautics Board should be declared unlawful and set aside insofar as it requires Texas International to refund to the Government $296,792 of the subsidy which it had received for calendar year 1966.

Respectfully submitted,



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BRIEF FOR RESPONDENT

IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 24,459

TEXAS INTERNATIONAL AIRLINES,

Petitioner,

v.

CIVIL AERONAUTICS BOARD,

Respondent.

ON PETITION FOR REVIEW OF AN ORDER OF THE
CIVIL AERONAUTICS BOARD

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ON PETITION FOR REVIEW OF AN ORDER OF THE
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BRIEF FOR RESPONDENT

COUNTERSTATEMENT OF THE ISSUE

The local service carrier subsidy program under Class Rate III-A required carriers to share profits in excess of specified levels with the Government. Before profits were recognized, however, the carriers were permitted to recoup their "actual income taxes, including the reduction of taxes from loss carrybacks and carryovers." The final and unchallenged rate formula provided that such taxes were to be those reported by the carriers "with such amendments and revisions as may have been filed as of the final determination or profit-sharing hereunder." In the uniform application of this rule, Texas International's tax credits arising from losses in 1968 and 1969, like those of a number of other carriers, were carried back to 1966 to reduce its taxes, increase

its profits, and increase its profit-sharing, whereas still other carriers' profit-sharing cases for 1966 did not reflect such consequences because they were closed before their losses for 1968 and 1969 were either reported or were to be reported in tax returns. The question presented is whether, under these circumstances, the Board's order carrying out the specific terms of the rate formula unlawfully discriminated against Texas International in such manner as to require its reversal and the retention by Texas International of some $300,000 of excessive profits created by subsidy payments it received for 1966.

COUNTERSTATEMENT OF THE CASE

Petitioner, Texas International Airlines, Inc. (Texas International) seeks review of an order of the Civil Aeronautics Board which required it to refund $296,762 of the subsidy payment which it received from the Government for 1966 [1/] pursuant to Class Rate III-A. [2/] Class Rate III-A provided for the payment of subsidy to local service carriers based upon a formula and subject to certain profit sharing provisions. These provisions required a carrier to refund some portion of the subsidy received when its profits after income taxes (including the subsidy) provided a rate of return beyond specified levels. Thus, when an air carrier received a tax refund reducing its actual tax payments for the subsidy

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1/ Order 70-5-108, May 21, 1970 (J.A. 27).

2/ For the orders promulgating Class Rate III-A, for 1966 see Order E-23697, May 18, 1966 and Order E-23850, June 23, 1966.

year in question prior to the final closing of the subsidy rate, its profits for that year were increased and part of the increase might be subject to profit-sharing with the Government. Due to operating losses incurred by the carrier during 1968 and 1969, Texas International established tax losses in those years which it was able to carry back to 1966, thus entitling it to a refund of taxes paid in that year. This tax refund reduced its actual taxes for 1966, increased its 1966 profits and increased the amount available for profit-sharing between Texas International and the Government in the above claimed amount. It is petitioner's contention that the Board did not carry back losses of some other carriers in the same fashion so as to require them to make comparable refunds and that it thereby discriminated against Texas International, with the result that the Board's order must be set aside.

A. The statutory basis for subsidy.

Under Section 406 of the Federal Aviation Act of 1958 (infra, p. 34), as well as its predecessor, air carriers holding certificates authorizing them to transport mail are eligible for two forms of mail pay: "service" and "subsidy." These two terms are used to describe these two different types of mail pay provided by Section 406. "Service" mail pay is calculated to compensate the carriers for the actual transportation of mail, is paid by the Post Office Department at rates fixed by the Board (Section 406(c), infra, p. 35) and is not involved in this case. "Subsidy" mail pay is paid to those mail certificated

carriers whose operations are not self-sustaining on the basis of "service" mail pay and commercial revenues and it is both fixed and disbursed by the Board. Section 406(b) of the Act (infra, p. 34) describes the basis of this subsidy as follows:

> ". . . the need of each such air carrier . . . for compensation . . . sufficient to insure the performance of such [mail] service, and, together with all other revenue of the air carrier, to enable such air carrier under honest, economical and efficient management to maintain and continue the development of air transportation to the extent and of the character and quality required for the commerce of the United States, the Postal Service and the national defense."

Thus, the basis for a carrier's subsidy is not the quantity of mail it transports, but its need in light of its total operations. 3/

The Board has customarily broken down a carrier's "need" into the following three elements:

> (1) the carrier's "break-even need," measured by the difference between its allowable cost of providing its subsidy eligible air-transport services, on the one hand, and its non-mail revenues from all sources, on the other; 4/
>
> (2) a return on the carrier's recognized investment sufficient to enable it to attract the private capital it needs in order to continue the development

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3/ This Court has had occasion to consider the subsidy provisions of the aviation acts in a number of earlier cases, including Trans World Airlines v. C.A.B., 128 U.S. App. D.C. 126, 385 F.2d 648 (1967), cert. denied 390 U.S. 944 (1968); Summerfield v. C.A.B., 92 U.S. App. D.C. 256, 207 F.2d 207 (1953), aff'd sub. nom. Delta Air Lines v. Summerfield, 347 U.S. 74 (1954); American Overseas Airlines, Inc. v. C.A.B., 103 U.S. App. D.C. 41, 254 F.2d 744 (1958); Transcontinental & Western Air, Inc. v. C.A.B., 83 U.S. App. D.C. 358, 169 F.2d 893 (1948), aff'd 336 U.S. 601 (1949).

4/ Delta - C. & S. Mail Rate Case, Reopened, 28 C.A.B. 820, 823 (1959).

of air transportation; 5/ and

(3) an allowance for income taxes paid, so that the stipulated after-tax return on investment will actually be available to the carrier's investors. 6/

Class Rate III-A is based upon these principles and reflects a desire on the part of the Board to make the local service carriers as a group economically self sufficient.

B. Background of Class Rate III-A.

Prior to the creation of Class Rate I in 1961, 7/ subsidy mail rates for local service carriers were determined on an individual basis.

5/ The Board has interpreted the Act as not authorizing it to meet the carriers' capital needs through direct subsidy, but only through a sufficient return on investment to attract new private capital. American Air., Mail Rates, 3 C.A.B. 323, 333 (1942); Capital Gains Proceeding, 27 C.A.B. 79, 82-6 (1958).

6/ Taxes not based on net income are taken into account under the heading of "break-even" need. Income taxes are treated separately because their amount cannot be determined until the desired after-tax return on investment has also been determined. When a final subsidy determination is made after the close of the period to which it applies, it is necessary in the final computation to take account of the tax effect of any refund or additional payment of subsidy ordered. This is because any additional payment will lead to additional tax liability, while a refund of subsidy will give the carrier a basis for a tax refund. In either case the added payment or refund of subsidy must be increased to offset the added tax liability or tax refund, so that the carrier's net after-tax return for the period will correspond to its "need" as determined by the Board.

7/ Local Service Class Subsidy Rate Investigation, 34 C.A.B. 416 (1961).

This method had several disadvantages including lengthy open rate periods, retroactive ratemaking and uncertainty of the carriers as to their subsidy. Therefore, the Board instituted a proceeding 8/ directed to the establishment of a uniform class subsidy mail rate for local service carriers to become effective January 1, 1961. The proposed class rate, while constructed on the basis of each individual carrier's need, was, nevertheless, a rate which was stated in terms of a class of carriers. The amounts of subsidy payable to each carrier varied in accordance with the rate formula depending upon volume of service, equipment utilized and density of operations; however, the same formula was applicable to all carriers in the class. The Board believed that the adoption of a class rate would provide stronger incentives for economical carrier operations than those which prevailed under a system of individual rates and that it would result in general in a long term reduction in subsidy costs and create a healthier and more vigorous local service industry. 9/ The carriers also foresaw the advantages of the class rate system and acquiesced in its adoption. On March 7, 1961 the Board adopted an order fixing the final rates for the carriers in Class Rate I.

The Board and the industry recognized that as the economic condition of the local service carriers changed the class rate would have

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8/ Local Service Class Subsidy Rate Investigation, Order E-16173, December 23, 1960.

9/ See Local Service Class Subsidy Rate Investigation, 34 C.A.B. 416, 432-433 for a discussion of the advantages of the class rate system.

to be revised from time to time. Accordingly, revisions were made in 1963 (Class Rate II),[10] 1964 (Class Rate III),[11] 1966 (Class Rate III-A),[12] and 1967 (Class Rate IV).[13] These changes were designed to simplify the mechanics of administration of subsidy payments, speed up the conclusion of profit-sharing determinations, and reduce the subsidy payments to the levels which the Congress and the Board felt desirable. Once again the carriers acquiesced in the changes.

Class Rate III-A which is here in question was adopted to become effective January 1, 1966, as an interim measure. It represented one of the changes made in the rate formula and was intended to subsidize the local service carriers with payments more closely related to the carriers' actual need. Like the prior class rates, Class Rate III-A requires that the carriers, under certain conditions, refund to the government a portion of the subsidy paid; that the refunds are to be made in accordance with the detailed profit-sharing provisions of the rate formula;[14] and that

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10/ Local Service Class Subsidy Rate, 39 C.A.B. 65 (1963).

11/ Local Service Class Subsidy Rate, 41 C.A.B. 138 (1964).

12/ Investigation of the Local Service Class Subsidy Rate, Orders E-23697, May 18, 1966 and E-23850, June 23, 1966.

13/ Orders E-25162, May 17, 1967 and E-25231, June 1, 1967. At the present time all local service carrier subsidy rates are "open" while a new class rate is being devised which will be retroactive to August 1, 1970. Investigation of the Local Service Class Subsidy Rate (Class Rate V), Order 70-7-148, July 31, 1970.

14/ The rate formula for Class Rate III-A is set forth in Order E-23850, June 23, 1966, and is reproduced in Appendix C, infra, p. 41 .

a special report, Form T-88, must be submitted by each local service carrier in order to facilitate the profit-sharing and subsidy refund calculations.[15/] Texas International challenges only the application of the profit-sharing provisions to its operations during 1966 in conjunction with the loss carrybacks stemming from its losses in 1968 and 1969.

C. The proceedings in the instant case.

On April 19, 1967, Texas International submitted Form T-88 in connection with the determination of its profit-sharing for 1966. As originally filed, it indicated a Federal income tax liability of $696,897 and an additional subsidy need of $232,710 for 1966. In other words, the petitioner's income after tax and before any profit-sharing was several hundred-thousand dollars less than the amount which Texas International might have earned under the applicable rates of return. However, after appropriate field audit, analysis, and adjustment, the Board's staff determined that petitioner should make a profit-sharing refund of $325,474. The main reason for the sharp change was that petitioner suffered a substantial loss in 1968 which, when carried back to 1966, resulted in a substantial tax refund for that year, a related increase in profits, and liability for a profit-sharing refund in the

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15/ The profit-sharing provisions of Class Rate III-A require the carriers to refund to the Board 50% of the profit between the recognized rate of return and a return of 15% on investment and 75% of the profits in excess of a return of 15% on investment. In general, the recognized rate of return for each carrier is determined by applying the specified percentage rates to the carriers' debt and equity components, subject to the minimum and maximum over-all rates of return.

amount indicated.[16] Texas International accepted the staff's adjustments other than the reduction of taxes resulting from the carryback of 1968 operating losses.[17] It submitted a memorandum detailing its objections on this issue (J.A. 83), and along with several other carriers having a like issue in their cases, presented oral argument to the Board.

On March 18, 1970, the Board announced its decision (Order 70-3-92, J.A. 13), holding that tax allowances for purposes of computing profit-sharing under Class Rates III and III-A for the years 1964-1966 should reflect the effect of credits relating to operating losses incurred under Class Rate IV in 1967-1969 which were carried back for tax purposes to 1964-1966. In reaching this conclusion with respect to 1967 and 1968 loss carrybacks the Board simply applied "the literal meaning of Section III-E" of the rate formula which it held was "clear and unambiguous" (J.A. 16).[18] However, a separate issue was presented for 1969, which the Board proceeded to discuss.

16/ The staff computed the loss to be $7,986,185. In reaching this figure the staff eliminated gains on the sale of certain flight equipment, thus increasing the loss and the loss carryback to 1966, decreasing 1966 taxes, and increasing 1966 profits and the profit-sharing refund.

17/ Texas International also challenged the staff treatment of gains on the sale of flight equipment. See note 16, supra. In Order 70-3-92, March 18, 1970, subsequently discussed in the text, the Board overruled the staff position on this issue, permitting capital gains to be recorded as income and thus reducing petitioner's 1968 losses, the loss carryback to 1966, the tax refund for 1966, and the amount of the profit-sharing refund for that year. That determination is not at issue here.

18/ "Federal and State income taxes shall be determined on the basis of the carrier's actual income taxes, including the reduction of taxes resulting from loss carrybacks and carryovers and from investment tax credits, as reported on its income tax returns submitted to taxing authorities for

(footnote continued)

The Board noted first that the carriers' tax returns for 1969 were due on March 15, 1970, a date just passed, but that the carriers, in accordance with their practice, had not yet filed their returns, and had not reflected loss carryback credits from 1969 against taxes paid in 1966, a profit-sharing year. No factual doubts were present as to the existence of losses in 1969 or the availability of loss carryback credits; the carriers' financial reports to the Board and their own admissions established the facts. The carriers contended, however, that "a literal application of the foregoing [tax] provision would not support the reduction of tax allowance on the basis of credits anticipated but not embodied in filed tax returns" (J.A. 22). In response, the Board said that "to accept such an argument is to ignore reality at the expense of the U.S. Treasury" (J.A. 22). It pointed to the facts that 1969 was over, the results were known, the tax returns were due, and the Form 41 reports filed with the Board "disclose that such credits will in fact be claimed" (J.A. 22). The Board went on to state that it "cannot in good conscience permit the tax allowance (of a carrier)

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each year, with such amendments and revisions as may have been filed as of the final determination of profit-sharing hereunder * * *" (emphasis added), Local Service Class Subsidy Rate, 41 C.A.B. 138, 169 (1964).

The Board also answered a contention raised by some carriers, but not raised by petitioner here, that the adoption of Class Rate IV amended Class Rates III and III-A so to repeal their loss carryback provisions. The Board rejected this contention and reaffirmed its long-standing policy, established in Western-Inland Mail Rates, 14 C.A.B. 201, 251-255 (1951), to compute tax allowances in subsidy cases only on the basis of "actual taxes" paid. See Trans World Airlines v. C.A.B., 128 U.S. App. D.C. 126, 385 F.2d 648, 668 (1967), cert. denied 390 U.S. 944 (1968).

to be affected by a matter so wholly within the control of the carriers as a request for an extension to file their income tax returns" (J.A. 22). The Board then decided to finalize profit-sharing for the year 1966 on the basis of either a pro forma tax return for 1969, or a copy of the actual return as filed with the Internal Revenue Service.

The Board turned finally to the carriers' contention that they were subjected to unlawful discrimination because, in some instances, other local service carriers had their profit sharing for the years under consideration established prior to the filing of their tax returns embodying loss carryback credits, and tax allowances for profit-sharing purposes therefore did not take these credits into account. The Board rejected the argument that it had discriminated among the carriers and pointed out the impracticability of keeping the rate for each carrier open for an indefinite period of time. The Board reaffirmed its policy of "relying upon the tax returns on file as of the date of the finalization of the rate or profit sharing case" (J.A. 24). Subsequent adjustments of the taxes, it noted, might well work to a carrier's benefit rather than to its detriment. It concluded on this issue by stating (J.A. 24):

> "The fact that some carriers' profit-sharing determinations were made final while the present carriers' cases were still pending provides no basis for departing from our actual tax policy and the tax provisions of the class rate orders. There is no claim that the Board or its staff has acted in an arbitrary fashion in the order in which the cases have been processed, and the Board has in fact attempted to process all of these cases as expeditiously as possible consistent with its workload and resources. Nevertheless, some cases must be processed before others, and if in this particular instance some carriers have benefited from the fact

> that their cases were completed more promptly than others, that fact would not warrant us in providing an excessive tax allowance for the carriers whose cases are still before us."

On May 21, 1970, the Board adopted an order applying the foregoing decision to the precise circumstances of petitioner and ordering it to refund $296,792 to the Government for the calendar year 1966 pursuant to Class Rate III-A (Order 70-5-108, J.A. 27). So far as here relevant that order provided as follows (J.A. 29):

> "6. Consistent with our actual tax policy, as reaffirmed in Order 70-3-92, March 18, 1970, and in accordance with the requirements of section III-E, we have adjusted federal income taxes for 1966, reported by Texas International on its Form T-88, to reflect the carryback of 1968 and 1969 net operating losses. As a result no provision has been made for federal income taxes for 1966."

It is this order which is now challenged by the petition for review.

ARGUMENT

Introduction

The challenged determination of the Board applied the literal language of the rate formula to Texas International and to all other carriers without discrimination. Petitioner does not claim otherwise. It contends only that it would be fairer if the rate formula had provided that all carriers either keep tax refunds generated from operating losses incurred under Class Rate IV or that all such refunds to the carriers be subjected to profit-sharing under Class Rate III-A. The difficulty is that Class Rate III-A made no such provision. Instead, it specifically provided that such tax "carrybacks and carryovers" would be utilized if they were reported on tax returns "filed as of

the final determination of profit-sharing hereunder" (App. C, infra, p. 41). These provisions were acquiesced in by petitioner and judicial review of their validity was not sought. Now, as closed final rates they may not be altered by the Board retroactively. Transcontinental & Western Air Lines, Inc. v. C.A.B., 336 U.S. 601 (1949).

Nor are the merits of the rate formula established by Class Rate III-A open for consideration in this proceeding. In the very order challenged herein the Board stated that "[t]he administration of profit-sharing and subsidy refunds does not involve rate-making determinations and the profit-sharing provisions of the Class Rate III-A formula are final, are not open to contest retroactively, and are not in issue" (J.A. 27). The courts have recognized the validity of this view,[19/]

19/ In Wynnewood Park Corporation v. Bowles, 143 F.2d 355, 356 (Emer. C.A., 1944), the Emergency Court of Appeals observed in an analagous situation: "The only question which the complaint properly raises is whether the Regional Administrator acted arbitrarily or capriciously in denying the complainant an adjustment under Section 5(a)(5) of the Regulation. Although the complainant's protest included an objection to the Regulation itself that objection was clearly out of time and, therefore, not open to our consideration." In the same vein is Hastings v. Bowles, 140 F.2d 981, 982 (Emer. C.A., 1944), where the Court said, "But the protest does not challenge the validity of the regulation for failure to provide an adjustment provision covering the type of situation here disclosed." See also Mohawk Airlines, Inc. v. C.A.B., 117 U.S. App. D.C. 326, 329 F.2d 894 (1964), and compare North Central Airlines, Inc. v. C.A.B., 124 U.S. App. D.C. 251, 363 F.2d 983 (1966). In the first of these cases, a "letter" declaring the Board's intention with respect to a subsidy refund was recognized to involve only subsidy administration rather than ratemaking and was held not to be a reviewable order. In the North Central case, a similar "order" of the Board was held reviewable, but it was recognized that only the application or meaning of the Board's class rate order was involved rather than the validity of its substance. The court interpreted the term "taxes" in

(footnote continued)

and Texas International takes no exception to this necessary limitation of the issues. To the contrary, asserting that the Board "granted certain carriers an allowance for income taxes for 1966 which it denied Texas International," it poses the sole issue in the case as being whether this constituted an unlawful discrimination (Pet. Br. 1). Nevertheless, its principal argument in support of the allegation of discrimination is that the consequences of applying the tax and profit-sharing provisions of Class Rate III-A fell unequally on itself as compared with Frontier Airlines (Pet. Br. 16-19), and that such discrimination could have been avoided either by allowing all carriers to keep their tax refunds, as Frontier was permitted to do, or by requiring all carriers to carryback their losses and use the tax credits to generate subsidy refunds (Pet. Br. 14-15, 25-26). It is evident that this is an argument that the formula of Class Rate III-A is deficient in its view and that some other formula would have been more to its liking. Such arguments, which were never made to the Board 20/ and which come more than four years after the order establishing

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the Board's class rate order as not subject to reduction for investment tax credits because of the Congressional directive in the legislation establishing the credits. It did not purport to change the class rate order but only to apply its terms. In the present case petitioner's objectives cannot be achieved by interpreting the class rate order but only by changing it, and it is now too late to challenge the class rate order.

20/ Under Section 1006(e) of the Act (infra, p. 36) matters not raised before the Board may not be considered by the Court.

the formula,[21] are not open for consideration here. Here, as the Board made clear, we are dealing solely with the administration of Class Rate III-A.

We shall demonstrate below that the challenged order of the Board embodied a faithful application of the unambiguous provisions of the rate formula, that the formula was applied even-handedly insofar as is administratively feasible, and that any differences in results to the carriers flowing from such administration does not constitute an unlawful discrimination warranting the reversal of the Board's order and the retention by Texas International of subsidy payments for 1966 in excess of the "need" Congress provided for in the statute.

I. The Board's refund order resulted from a reasonable and necessary application of the tax and profit-sharing provisions of Class Rate III-A to the uncontested facts of this case..

A. The facts and the ruling on the 1968 losses.

There is no dispute that the profit-sharing determination for Texas International for 1966 under Class Rate III-A was not concluded until May of 1970 (J.A. 27).[22] Nor is there any question that at that time Texas International had filed a tax return for 1968 showing an operating

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21/ Under Section 1006(a) of the Act (infra, p. 36) petitions for review of orders of the Board must be filed within 60 days of their entry unless the Court permits a late filing for good cause.

22/ "This process of settling the amount, if any, of profit to share ordinarily ran at least well into the second year following the year under review, and frequently took much longer." (Pet. Br. 8).

loss which it proposed to carryback to 1966 to obtain a refund of taxes paid in 1966 (J.A. 81). Whether these facts would generate a profit-sharing refund to the Government depends upon the application of the relevant provision of Class Rate III-A. As indicated in the statement (supra, p. 8), the challenged order of the Board (J.A. 27) adjusted federal income taxes for 1966 to reflect the 1968 operating loss.[23/] The action was taken in reliance of Order 70-3-92, which has already been discussed in detail above (supra, 9-12). Suffice it to say here that the tax provision of the Class Rate III-A rate formula (infra, p. 9) unequivocally calls for the payment only of "actual income taxes," that it is "clear and unambiguous" in requiring "the reduction of taxes resulting from loss carrybacks," and that it encompasses such adjustments to tax returns for the year under review "as may have been filed as of the final determination of profit-sharing hereunder." There is not the slightest doubt that the Board's action on the 1968 operating losses was a proper application of Class Rate III-A in accordance with its terms and petitioner does not even contend otherwise.

B. The facts and the ruling on the 1969 losses.

The Board's ruling on the 1969 losses was the same as on the 1968 losses--namely, to carry back the losses to 1966, thus eliminating

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23/ The order also reflected the carryback of the 1969 operating loss. Taken together the losses for the two years wiped out any federal tax liability for 1966 and gave rise to the profit-sharing refund ordered by the Board. The facts relating to the 1969 operating losses differ to some extent from those for 1968 and are discussed separately in the next section of this brief.

any tax liability for Texas International for 1966 and giving rise to the profit-sharing refund contested in this case. However, the facts relating to the 1969 losses differed from those for 1968, and petitioner contends in substance that, because of this difference, 1969 losses should not have been carried back even if 1968 losses were (Pet. Br. 11-12, 27). The salient difference between the two years is that at the time the Board ruled that 1968 and 1969 losses should be carried back to 1966 (March 18, 1970), Texas International had filed its tax return for 1968 (Pet. Br. 10) but had not done so for 1969 (P. Br. 12, J.A. 89). Instead, in 1969, when its tax return was due it requested and received leave to delay filing its return from March 15 to September 30, 1970. This issue was presented to the Board and, after careful consideration, rejected (J.A. 21).

In reaching its conclusion, the Board was aware that "a literal application of the tax provisions of the rate formula would not support the reduction of tax allowances on the basis of credits anticipated but not embodied in filed tax returns," but it chose not to "ignore reality" and not to "permit the tax allowance to be affected by a matter so wholly within the control of the carriers as a request for an extension to file their income tax returns" (J.A. 22). In reaching this conclusion the Board reiterated its long-held view that it should not speculate as to what tax returns would show for a future period but should take them "as it finds them." However, it noted that 1969 results were "no longer a matter of forecast;" the Form 41 reports of the carriers were filed with the Board and their tax returns were due;

and the rate formula required the reflection of the tax credits had the tax returns been filed as the statute required. The Board simply refused to permit carriers to shuck off profit-sharing refunds by the expedient of postponing the filing of tax returns. The Board's approach to the meaning and application of its own regulations relating to subsidy administration are wholly reasonable, on a sound legal footing, and should not be disturbed by the Courts.

In the first place, the Board was interpreting its own regulation in the administration of a statute entrusted to it by the Congress. Under such circumstances, the Board's view is entitled to great weight. United States v. American Trucking Associations, Inc., 310 U.S. 534, 549 (1940); Skidmore v. Swift & Co., 323 U.S. 134, 139-140 (1944); Udall v. Tallman, 380 U.S. 1, 16 (1965); Railway Express Agency, Inc. v. C.A.B., 120 U.S. App. D.C. 228, 345 F.2d 445, cert. denied, 382 U.S. 879 (1965). Moreover, in departing from the literal language of its rate formula, in this case in favor of the maintenance of its "actual tax" policy on a realistic basis, the Board was not breaking new ground but rather was following a furrow well-ploughed by judicial precedent.[24/] Finally, in opting for a realistic rather than a literal reading of its rate formula the Board laid emphasis on the fact that it was dealing with

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24/ See Justice Reed's classic discussion of the problem in United States v. American Trucking Associations, Inc., 310 U.S. 534, 543-544 (1940):

> "There is, of course, no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes. Often these words are sufficient in and of themselves
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> (footnote continued)

U.S. Treasury funds and the payment of subsidies, factors which this Court has previously held justify a protective administration by the Board. "Rigor is a particularly appropriate watchword when regulatory agencies superintend payments from the public fisc." Trans World Airlines v. C.A.B., 128 U.S. App. D.C. 126, 385 F.2d 648, 664 (1967), cert. denied, 390 U.S. 944 (1968). Clearly judicial intervention with the Board's determination to finalize profit-sharing for 1966 on the basis either of a pro forma tax return for 1969 or the actual return is unwarranted under the circumstances here present.

> to determine the purpose of the legislation. In such cases we have followed their plain meaning. When that meaning has led to absurd or futile results, however, this Court has looked beyond the words to the purpose of the act. Frequently, however, even when the plain meaning did not produce absurd results but merely an unreasonable one 'plainly at variance with the policy of the legislation as a whole' this Court has followed that purpose, rather than the literal words. When aid to construction of the meaning of words, as used in the statute, is available, there certainly can be no 'rule of law' which forbids its use, however clear the words may appear on 'superficial examination.' . . . A few words of general connotation appearing in the text of statutes should not be given a wide meaning, contrary to a settled policy, 'excepting as a different purpose is plainly shown.'" [footnotes omitted]

See also United States v. National Marine Engineers' Beneficial Ass'n, 294 F.2d 385, 391 (C.A. 2, 1961), and Perry v. Commerce Loan Co., 383 U.S. 392, 399-400 (1966).

II. <u>There was no unlawful discrimination against Texas International which would justify reversal of the Board's order and retention by Texas International of subsidy payments in excess of its "need" for 1966.</u>

Petitioner's only claimed basis for relief in this case is that the Board discriminated against it by requiring it to make profit-sharing refunds for 1966 resulting from tax credits created by the carryback of operating losses incurred in 1968 and 1969, whereas other carriers, particularly Frontier, were not required to carry back operating losses for those years to be reflected in 1966 profit-sharing refunds, but instead were permitted to retain the tax refunds they obtained based on losses for 1968 and 1969 (Pet. Br. 1, 14, 16). Petitioner claims that this discrimination "is undisputed" (Pet. Br. 1, 14, 16) and that "the Board's opinion below concedes as much" (Pet. Br. 16). Neither claim is true. The Board did consider the contention of discrimination in some detail, as we set forth in the statement (<u>supra</u>, p. 11). It plainly indicated that it treated all carriers similarly situated in the same fashion, although, since all profit-sharing cases could not be decided at the same time, different consequences could and did flow from the finalization of different profit-sharing cases at different times. We shall show that its even-handed procedure was well within its authority, faithfully applied the applicable rate formula, and avoided the windfall payments petitioner seeks which would violate the statutory command that subsidy payments only fulfill the "need" of the carrier.

We have set forth in Appendix B (<u>infra</u>, p. 38) a summary showing the Board's action in all profit-sharing cases. Reference to this

chart will demonstrate the non-discriminatory character of the Board's determinations. In every instance carriers situated the same have been treated the same. There is no discrimination.[25/]

Nevertheless, petitioner argues that the treatment of profit-sharing of four local service carriers, particularly Frontier Airlines, shows that the Board has discriminated against it (Pet. Br. 8, 12-14, 16-19). However, none of the cases of the four carriers cited by petitioner are in point. The profit-sharing determinations for each of these carriers was settled prior to that of Texas International and before the fact of 1968 losses was established. As a result, 1968 losses could not be carried back to 1966 for these carriers.[26/] Since petitioner singles out Frontier particularly, we will examine Frontier's profit-sharing to show that it did not give rise to any discrimination against Texas International.

Texas International contends that the treatment of 1968 loss carrybacks in Frontier's 1966 profit-sharing was different from the

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25/ We endorse petitioner's quotations from Justice Cardozo and Judges Prettyman and Friendly (Pet. Br. 16, 19-20) but they are inapposite here since carriers in the same situation at the same time have in fact been treated in the same way.

26/ As Appendix B shows, the Board closed Southern Airways Class Rate III-A profit-sharing in March, 1969 without a carryback to 1966, since Southern's entire operating losses were carried back to 1965 and earlier years. Mohawk Airlines paid no taxes in 1966, and therefore later losses could not be carried back to recover taxes in that year. North Central's profit-sharing case was closed at a time before its 1968 losses were known. Its case is similar to that of Frontier (though less extreme), which is discussed in the following text.

manner in which its profit-sharing was treated and that such differences were not due to timing alone, but to a decision in principle not to capture the company's 1968 loss carryback. Petitioner characterizes this as an arbitrary and capricious discrimination by the staff. In the Frontier case, the staff and the carrier reached agreement on its profit-sharing for 1964, 1965 and 1966 in November, 1968, although the final order was not issued until January, 1969. The Form 41 reports filed by Frontier for the first three-quarters of 1968 showed a loss position for Frontier similar to that shown by Texas International (Compare J.A. 46 with J.A. 58). However, the staff does not make profit-sharing determinations based merely upon the results from the first three-quarters of any year. This is because the carrier in question could have a profit in the final quarter and therefore have no losses to carryback against previously paid taxes. Further, even though losses from the first three-quarters were heavy and it might be unlikely that they could be made up from operations, they nevertheless could be altered radically by sales of equipment, mergers, acquisitions, or other transactions with substantial tax consequences. Thus in Frontier's case, when the Board and the airline came to agreement on profit-sharing, 1968 was not over and the tax consequences of that year's operations were not used. On the other hand, when petitioner's 1966 profit-sharing was finally determined in May 1970 (J.A. 27), its 1968 and 1969 results were finally determined and the tax consequences of those years' loss operations were used. Since this fact was known by the staff they were

bound by the Board's actual tax policy to take these losses into account. 27/

Although petitioner here complains of the favored treatment received by Frontier on its 1966 profit-sharing, petitioner was the recipient of precisely the same kind of treatment on its own profit-sharing settlement for 1965. Thus, on November 4, 1968, the Board issued Order 68-11-15 determining that petitioner refund $774,572 of the subsidy it had received for 1965 under Class Rate III. On November 4, 1968, the Board had on file three quarterly Form 41 Reports of Texas International indicating that the carrier would likely have substantial losses in 1968. 28/ However, the Board did not delay closing the rate to capture

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27/ The failure of the Board to consider a carrier's actual income taxes, including its carryback credits would involve a retroactive amendment to the class rate order which is barred by the principle of Transcontinental and Western Air Lines, Inc. v. C.A.B., 336 U.S. 601 (1949). In that case the Court held that the Civil Aeronautics Board is without authority, under the Civil Aeronautics Act of 1938, as amended, to fix a new mail rate for air carriers and to make it retroactive for a period in which a final rate previously fixed by the Board was in effect and unchallenged by the institution of a mail rate proceeding.

28/ Texas Int'l - Class Rate III (1965)

Quarter Ending	Profit (Loss)	Inc. Taxes (Cr.)	Profits (loss) After Taxes
3/31/68	(841,386)	(396,631)	(444,755)
6/3/68	(321,389)	(306,156)	(15,233)
9/30/68	150,962	96,012	54,950
Sub Total	(1,011,813)	(606,775)	(405,038)
12/31/68	(1,473,909)	(396,260)	(1,077,649)
Total	(2,485,722)	(1,003,035)	(1,483,687)

the benefits of these losses since all of the Form 41's for the year's operations had not been filed. Later Texas International filed its final Form 41 for 1968 which also showed a loss. However, since profit-sharing was closed, Texas International was able to keep the benefit of the loss carryback, just as Frontier did for 1966.

The Board in this case has applied its "actual tax" policy as it always has been applied to all carriers who are similarly situated.[29/] That policy is to predicate the carrier's allowances for taxes on the basis of the carrier's actual income tax liability so far as it is known at the time of Board determination. The Board has always been aware of the fact that in the normal course of the administration of tax laws, the carrier's taxes for a given year are subject to change after the Board's determination is made final. It would be totally unfeasible to attempt to hold open each case until all possibility of amendment to the carrier's tax returns for that year had passed. Taxes can be affected by carryback credits, by voluntary amendments of returns by the taxpayer and by a deficiency assessment of the Internal Revenue Service, and were the Board to defer its final action on profit-sharing matters until the

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29/ Western Air Lines, Inc. and Inland Air Lines, Inc., Mail Rates, 14 C.A.B. 201, 251-255 (1951), aff'd. Summerfield v. C.A.B., 92 U.S. App. D.C. 248, 254, 207 F.2d 200, 206 (1953), aff'd sub nom. Western Air Lines, Inc. v. C.A.B., 347 U.S. 67 (1954); cited with approval in Trans World Airlines v. C.A.B., 128 U.S. App. D.C. 126, 385 F.2d 648, 668 (1967), cert. denied, 390 U.S. 944 (1968), where this Court concluded "that so far as subsidy administration is concerned the 'actual tax' policy is correct as a general principle, and no considerations of fairness require enhancement of 'actual tax' to include the accrual of the tax reserves under discussion."

various statutory limitation periods expired, it would be virtually impossible to maintain carriers on a current rate status and there would be continual uncertainty as to the government's obligation under Section 406, as well as uncertainty as to the carrier's revenues. It is for these reasons that the Board has followed the practice of relying upon the tax returns on file as of the date of the profit-sharing determination. In this manner, both the carrier and the Board are bound by the facts then existing. Subsequent changes in the tax allowance may work to the carrier's benefit or to its detriment, and the carrier takes the risk that a subsequent deficiency assessment by the Internal Revenue Service will occur in a closed rate period and will not be underwritten under Section 406. By the same token, tax refunds for the year become beyond the reach of the Board if they occur during a closed rate period.

We recognize that not every profit-sharing case has been processed at precisely the same point of time. This is no more feasible administratively for the Board than it is for the courts. Necessarily some cases must be processed before others and, depending on circumstances largely beyond the control of the carriers or the Board, early processing may be either beneficial or detrimental to the carrier. In this case it is now apparent that early processing would have been preferable to petitioner. In considering these circumstances, the Board held that they did not afford it a basis for departing from its actual tax policy or the tax provisions of the class rate orders. It noted specifically (J.A. 24):

> "There is no claim that the Board or its staff has acted in an arbitrary fashion in the order in which the cases have been processed, and the Board has in fact attempted to process all of these cases as expeditiously as possible consistent with its workload and resources."

Petitioner concedes that "[i]f by this the Board meant that there is no claim of bias in its selection of the order in which it processed the carriers' rates, it is correct, but certainly this procedure was arbitrary" (Pet. Br. 26).

The question of the ordering of the Board's docket is a matter for its own determination. In conformity with familiar principles, this Court has declared that "No principle of administrative law is more firmly established than that of agency control of its own calendar." City of San Antonio v. C.A.B., 126 U.S. App. D.C. 112, 374 F.2d 326, 329 (1967).[30] That being the case, and there being no charge of bias in the ordering of profit-sharing cases followed by the Board, petitioner's claim is simply one that it should not be deprived of benefits received by other carriers because its case was processed later than the other carriers. The Board characterized this argument as being based on "administrative lag" and rejected it on the basis of its decision in National Air Lines, Inc., Mail Rates, 18 C.A.B. 442 (1954).[31]

30/ See also F.C.C. v. Pottsville Broadcasting Co., 309 U.S. 134, 138 (1940); C.A.B. v. State Airlines, Inc., 338 U.S. 572, 576 (1950); Frontier Airlines, Inc. v. C.A.B., 349 F.2d 587, 591 (C.A. 10, 1965); Western Air Lines, Inc. v. C.A.B., 184 F.2d 545 (C.A. 9, 1950).

31/ In that case it was contended by National that the subsidy it would have received would have been higher if there had not been an unreasonable delay by the Board in processing its case and it sought to introduce evidence of the delay. The Board refused to follow this course, saying: (footnote continued)

In this case, as in the National case, the Board was moved to reject the argument advanced because administrative lag "would not warrant us in providing an excessive tax allowance for the carriers whose cases are still before us" (J.A. 25). There is no question but that subsidy payments under Section 406 of the Act (infra, p. 34) are limited by the "need" of the carrier, and that the Class Rate III-A rate order must be interpreted with a similar restriction to the "need" of the carrier. When the payments authorized by the Board have departed from the standard of "need", the courts have emphatically rejected them. Delta Air Lines, Inc. v. Summerfield, 347 U.S. 74 (1954); Western Air Lines, Inc. v. C.A.B., 347 U.S. 67 (1954); American Overseas Airlines, Inc. v. C.A.B., 103 U.S. App. D.C. 41, 254 F.2d 744 (1958).

In the present case the "need" of a carrier is fixed by the formula provided in Class Rate III-A, including its profit-sharing and tax provisions. A carrier like Frontier, for example, could not be deprived of its actual tax payments for 1966 as shown at the time of its profit-sharing determination without violating Class Rate III-A. On the other hand, at the time of petitioner's profit-sharing determination, any allowance to it for actual taxes paid for 1966, when they had in fact been

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"Evidence of such character is, in our opinion, clearly irrelevant to a proceeding under Section 406 of the Act, and to permit the introduction of such evidence would, in our judgment, needlessly incumber the record and might distort the issues appropriate for exploration in a mail rate hearing. The issue to be tried is what, under all the circumstances, is the fair and reasonable rate . . . for the open period in question. It is fruitless to indulge in conjecture as to what might have happened if a different set of circumstances had prevailed." (18 C.A.B. 442)

refunded,[32/] also would have violated the class rate order and given it subsidy in excess of its need.

Petitioner attempts to avoid this pitfall by simply arguing that all carriers should be treated the same. But there is no way to do what petitioner wants under Class Rate III-A, and it has suggested none. As indicated earlier, it is really attacking the class rate order in a procedurally defective manner because it is not in issue here (see p. 13 , supra, and J.A. 27). This it cannot do. See the cases cited in note 19 , supra. Moreover, there is no way to make two determinations rendered at different times of equal impact. Frontier, for example, while not required to carry back 1968 and 1969 losses, as petitioner had to do, was required to refund substantial funds in a tight money market, while petitioner was not. Similarly, once Frontier's profit-sharing case was closed, deficiency assessments by IRS for 1966 were for its own account. On the other hand, such assessments against petitioner for 1966 were part of its "actual tax" burden and therefore payable by the Board because its profit-sharing case was open. The rate formula establishes a two-way street on which benefits and burdens flow. The closing of a profit-sharing case terminates both. Until closing, adjustments in either direction are open. It is apparent that it is not administratively feasible or desirable to explore the myriad of differences which might advantage or disadvantage a carrier by having its profit-sharing determined at one time rather than another.

32/ As noted earlier (supra, p. 17) the filing of petitioner's 1969 tax return was delayed and after its due date a pro forma return was used in its place in making the profit-sharing determination.

As previously shown, the Board was not free to exercise its discretion in the administration of the rate formula to grant the relief petitioner requested. Transcontinental and Western Air Lines, Inc. v. C.A.B., 336 U.S. 601 (1949). Even if such discretion were assumed to exist, arguendo, there was no such discrimination as to render the Board's action unlawful. In rejecting administrative lag as a basis for granting petitioner subsidy payments in excess of its "need" the Board's decision was consistent with applicable determinations of the Courts. In addition to the dispositive subsidy cases referred to above, the courts have taken similar action in comparable cases against charges of discrimination by administrative agencies and lack of uniformity in the application of decisional principles. N.L.R.B. v. Rutter-Rex Mfg. Co., 396 U.S. 258 (1969); Moog Industries v. F.T.C., 355 U.S. 411 (1958); cf. Federal Communications Commission v. WOKO, 329 U.S. 223 (1946).

In N.L.R.B. v. Rutter-Rex Mfg. Co., supra, the Supreme Court held that although a four year administrative delay had prejudiced the petitioner, it did not excuse it from the duty of giving "back-pay" to workers it had failed to reinstate after wrongfully refusing to bargain with a labor union. The Court of Appeals had modified the back-pay order on the basis of the long administrative delay in obtaining compliance. The Court held that such modification was an unwarranted interference with the Board's remedial power to implement the policies of the National Labor Relations Act. There, as here, the company was required to make a greater refund than might have been required absent administrative delay in order to comply with statutory objectives.

In Moog Industries v. F.T.C., supra, the Supreme Court stated that "[t]he general question presented by these two cases is whether it is within the scope of the reviewing authority of a Court of Appeals to postpone the operation of a valid cease and desist order of the Federal Trade Commission against a single firm until similar orders have been entered against that firm's competition" (355 U.S. at 411-12). The Court held that "the decision as to whether or not an order against one firm to cease and desist from engaging in illegal price discrimination should go into effect before others are similarly prohibited depends on a variety of factors peculiarly within the expert understanding of the Commission. * * * If the Commission has decided the question, its discretionary determination should not be overturned in the absence of a patent abuse of discretion" (355 U.S. at 413-14). Thus, the court refused to revise agency action where one member was proceeded against out of many who were similarly situated.

Finally, in view of the charge of discrimination leveled at the Board, reference should be made to the host of tax cases which demonstrate that the mere fact that different results are reached with respect to different persons does not justify the nullification of administrative action in the absence of a showing of calculated and intentional discrimination. Charleston Ass'n. v. Alderson, 324 U.S. 182 (1945); Brown County, Texas v. Atlantic Pipe Line Co., 91 F.2d 394 (C.A. 5), cert. denied 302 U.S. 747 (1937); Rowley v. Chicago & Western R. Co., 293 U.S. 102 (1934). Plainly there is no intentional and systematic discrimination here (cf. Pet. Br. 26) as these cases would require before remedial action under the Constitution would be justified.

The cases cited by petitioner in its brief (pp. 20-24), like West Ohio Gas Co. v. Public Utilities Commission, 294 U.S. 63 (1935), are not apposite here. In fact, the introduction to petitioner's discussion discloses why this is so. It characterizes the present case as one of "discriminatory decision-making" and it offers precedents in that area. But the challenged order of the Board is not a ratemaking decision. In the words of the Board, "The administration of profit-sharing and subsidy refunds does not involve ratemaking determinations and the profit-sharing provisions of the Class Rate III and III-A formulas are final, are not open to contest retroactively, and are not in issue." (J.A. 27). Petitioner does not contest this. Yet it offers as support for its position only cases in which the agency was making a rate or route determination with freedom to change its policies so long as it explained its position. Here the Board was bound to adhere to the provisions of Class Rate III-A, a course which it followed without discrimination.

CONCLUSION

For the foregoing reasons the challenged order of the Board, and the opinion on which it relies, should be affirmed.

Respectfully submitted,

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APPENDIX A

Relevant provisions of the Federal Aviation Act of 1958, 72 Stat. 737, 49 U.S.C. 1301, et seq.:

* * * * *

TITLE IV--AIR CARRIER ECONOMIC REGULATION

Certificate of Public Convenience and Necessity

* * * * *

Sec. 401 (49 U.S.C. 1371)

* * * * *

Requirement as to Carriage of Mail

(1) Whenever so authorized by its certificate, any air carrier shall provide necessary and adequate facilities and service for the transportation of mail, and shall transport mail whenever required by the Postmaster General. Such air carrier shall be entitled to receive reasonable compensation therefor as hereinafter provided.

* * * * *

Transportation of Mail

Postal Rules and Regulations

Sec. 405 (49 U.S.C. 1375)

* * * * *

Tender of Mail

(d) From and after the issuance of any certificate authorizing the transportation of mail by aircraft, the Postmaster General shall tender mail to the holder thereof, to the extent required by the Postal Service, for transportation between the points named in such certificate for the transportation of mail, and such mail shall be transported by the air carrier holding such certificate in accordance with such rules, regulations, and requirements as may be promulgated by the Postmaster General under this section.

* * * * *

Rates For Transportation of Mail

Authority to Fix Rates

Sec. 406. (49 U.S.C. 1376).(a) The Board is empowered and directed, upon its own initiative or upon petition of the Postmaster General or an air carrier, (1) to fix and determine from time to time, after notice and hearing, the fair and reasonable rates of compensation for the transportation of mail by aircraft, the facilities used and useful therefor, and the services connected therewith (including the transportation of mail by an air carrier by other means than aircraft whenever such transportation is incidental to the transportation of mail by aircraft or is made necessary by conditions of emergency arising from aircraft operation), by each holder of a certificate authorizing the transportation of mail by aircraft, and to make such rates effective from such date as it shall determine to be proper; (2) to prescribe the method or methods, by aircraft-mile, pound-mile, weight, space, or any combination thereof, or otherwise, for ascertaining such rates of compensation for each air carrier or class of air carriers; and (3) to publish the same.

Rate Making Elements

(b) In fixing and determining fair and reasonable rates of compensation under this section, the Board, considering the conditions peculiar to transportation by aircraft and to the particular air carrier or class of air carriers, may fix different rates for different air carriers or classes of air carriers, and different classes of service. In determining the rate in each case, the Board shall take into consideration, among other factors, (1) the condition that such air carriers may hold and operate under certificates authorizing the carriage of mail only by providing necessary and adequate facilities and service for the transportation of mail; (2) such standards respecting the character and quality of service to be rendered by air carriers as may be prescribed by or pursuant to law; and (3) the need of each such air carrier (other than a supplemental air carrier) for compensation for the transportation of mail sufficient to insure the performance of such service, and, together with all other revenue of the air carrier, to enable such air carrier under honest, economical, and efficient management, to maintain and continue the development of air transportation to the extent and of the character and quality required for the commerce of the United States, the Postal Service, and the national defense. In applying clause (3) of this subsection, the Board shall take into consideration any standards and criteria prescribed by the Secretary of Transportation, for determining the character and quality of transportation required for the commerce of the United States and the national defense.

Payment

(c) The Postmaster General shall make payments out of appropriations for the transportation of mail by aircraft of so much of the total compensation as is fixed and determined by the Board under this section without regard to clause (3) of subsection (b) of this section. The Board shall make payments of the remainder of the total compensation payable under this section out of appropriations made to the Board for that purpose.

Treatment of Proceeds of Disposition of Certain Property

(d) In determining the need of an air carrier for compensation for the transportation of mail, and such carrier's "other revenue" for the purpose of this section, the Board shall not take into account--

(1) gains derived from the sale or other disposition of flight equipment if (A) the carrier notifies the Board in writing that it has invested or intends to reinvest the gains (less applicable expenses and taxes) derived from such sale or other disposition in flight equipment, and (B) submits evidence in the manner prescribed by the Board that an amount equal to such gains (less applicable expenses and taxes) has been expended for purchase of flight equipment or has been deposited in a special reequipment fund, or

(2) losses sustained from the sale or other disposition of flight equipment.

Any amounts so deposited in a reequipment fund as above provided shall be used solely for investment in flight equipment either through payments on account of the purchase price or construction of flight equipment or in retirement of debt contracted for the purchase or construction of flight equipment, and unless so reinvested within such reasonable time as the Board may prescribe, the carrier shall not have the benefit of this paragraph. Amounts so deposited in the reequipment fund shall not be included as part of the carrier's used and useful in investment for purposes of section 406 until expended as provided above: Provided, That the flight equipment in which said gains may be invested shall not include equipment delivered to the carrier prior to April 6, 1956: Provided further, That the provisions of this subsection shall be effective as to all capital gains or losses realized on and after April 6, 1956, with respect to the sale or other disposition of flight equipment whether or not the Board shall have entered a final order taking account thereof in determining all other revenue of the air carrier.

* * * * *

TITLE X--PROCEDURE

* * * * *

Judicial Review of Orders

Orders of Board and Administrator subject to Review

Sec. 1006. (49 U.S.C. 1486) (a) Any order, affirmative or negative, issued by the Board, or Administrator, under this Act, except any order in respect of any foreign air carrier subject to the approval of the President as provided in section 801 of this Act, shall be subject to review by the courts of appeals of the United States or the United States Court of Appeals for the District of Columbia upon petition, filed within sixty days after the entry of such order, by any person disclosing a substantial interest in such order. After the expiration of said sixty days a petition may be filed only by leave of court upon a showing of reasonable grounds for failure to file the petition theretofore.

Venue

(b) A petition under this section shall be filed in the court for the circuit wherein the petitioner resides or has his principal place of business or in the United States Court of Appeals for the District of Columbia.

Notice to Board or Administrator; Filing of Transcript

(c) A copy of the petition shall, upon filing, be forthwith transmitted to the Board, or Administrator, by the clerk of the court, and the Board or Administrator shall thereupon file in the court the record, if any, upon which the order complained of was entered, as provided in section 2112 of title 28, United States Code.

Power of Court

(d) Upon transmittal of the petition to the Board, or Administrator, the court shall have exclusive jurisdiction to affirm, modify, or set aside the order complained of, in whole or in part, and if need be, to order further proceedings by the Board or Administrator. Upon good cause shown and after reasonable notice to the Board or Administrator, interlocutory relief may be granted by stay of the order or by such mandatory or other relief as may be appropriate.

Findings of Fact Conclusive

(e) The findings of facts by the Board, or Administrator, if supported by substantial evidence, shall be conclusive. No objection to an order of the Board or Administrator shall be considered by the

court unless such objection shall have been urged before the Board or Administrator or, if it was not so urged, unless there were reasonable grounds for failure to do so.

Appendix B

SUMMARY OF LOCAL SERVICE CARRIER PROFIT-SHARING AND RELATED FEDERAL INCOME TAX DATA

PROFIT-SHARING YEARS 1964, 1965 AND 1966

	Gross Subsidy	Net Income (Loss) Per Form 41	Net Income (Loss) Per Tax Return	Federal Income Taxes Paid	Federal Income Taxes Refund from Carryback	Federal Income Taxes Recognized for Profit-Sharing	Final Profit-Sharing Order Number	Final Profit-Sharing Order Date	Final Profit-Sharing Order Amount
Allegheny									
1964	$5,899,513	441,024	(67,641)	- 0 -	- 0 -	- 0 -	70-6-9	6/1/70	Deficiency1/
1965	6,183,443	1,417,000	2,793,275	981,954	(981,954)	- 0 -	70-6-9	6/1/70	770,115
1966	5,359,325	1,248,000	2,138,576	750,021	(750,021)	- 0 -	70-6-9	6/1/70	287,523
1967	3,907,431	(516,000)	(1,393,136)	-	to '65				
1968	5,057,066	(2,430,000)	(3,970,739)	-	to '65 and '66				
1969	2,592,535	(10,924,286)							
Bonanza									
1964	3,311,740	1,219,931	1,135,208	512,855	- 0 -	512,855	Letter	2/24/67	Deficiency
1965	3,166,195	843,000	491,784	154,249	- 0 -	154,249	Letter	10/26/67	Deficiency
1966	3,581,000	862,000	899,865	312,830	- 0 -	414,638	Letter	6/17/68	Deficiency
1967	3,604,421	530,000	541,830	132,774	- 0 -				
1968(year merged)2/	995,177	210,000	83,804	6,049	- 0 -				
Central									
1964	4,255,557	141,536	119,820	34,412	- 0 -	34,412	Letter	1/23/67	Deficiency
1965	4,138,644	(187,000)	(446,511)3/	(182,245)	- 0 -	(296,803)	Letter	9/21/67	Deficiency
1966	4,633,131	405,000	323,070	143,432	62,024	81,408	Case remains open		
1967(year merged)	3,288,143	93,000	(234,525)						
Lake Central									
1964	3,867,231	353,691	128,814	24,086	(24,086)	- 0 -	E-26919	6/14/68	23,853
1965	3,937,974	344,000	336,593	97,548	(97,548)	- 0 -	70-6-10	6/1/70	88,041
1966	3,958,537	(63,000)	(486,213)	- 0 -	to '65	- 0 -	Letter	6/8/70	Deficiency
1967	4,154,879	(4,248,000)	(5,060,863)	- 0 -	to '65				
1968(year merged)4/	1,788,309	(2,394,000)	(2,368,044)	- 0 -	N.A.				
Frontier									
1964	7,817,754	1,553,508	1,733,599	616,764	(616,764)	- 0 -	69-1-99	1/24/69	1,009,808
1965	7,321,229	1,313,000	2,882,096	1,013,219	(1,013,219)	729,292	69-1-99	1/24/69	1,524,181
1966	5,780,000	1,790,000	2,319,034	806,444	(806,444)	806,444	69-1-995/	1/24/69	787,195
1967(includes Central)	8,694,201	(121,000)	(2,134,533)		to '64 & '65				
1968	7,554,248	(6,811,000)	CLOSED						
1969	6,752,020	(12,213,714)	CLOSED						
Mohawk									
1964	4,438,556	2,246,000	2,123,314	1,025,968	(1,025,968)	- 0 -	68-12-125	12/23/68	1,078,472
1965	4,356,491	2,654,000	2,649,180	930,080	(930,080)	- 0 -	69-9-102	9/17/69	919,130
1966	3,292,464	593,000	1,996,303	707,202	(707,202)	- 0 -	Letter	10/2/69	Deficiency
1967	3,656,578	(274,000)	(2,512,857)	- 0 -	-				
1968	3,021,993	(4,360,000)	(7,274,482)	- 0 -	-				
1969	2,126,528	4,729,000							

	Gross Subsidy	Net Income (Loss) Per Form 41	Net Income (Loss) Per Tax Return	Federal Income Taxes Paid	Federal Income Taxes Refund from Carryback	Federal Income Taxes Recognized for Profit-Sharing	Final Profit-Sharing Order Number	Final Profit-Sharing Order Date	Final Profit-Sharing Order Amount
North Central									
1964	$7,894,121	1,546,474	1,801,549	836,200	(836,200)	836,200	E-25235	6/2/67	761,472
1965	7,959,405	1,139,000	2,147,976	941,290	(941,290)	941,290	E-26396	2/23/68	973,805
1966	5,992,720	1,155,000	1,614,948	764,367	(764,367)	764,367	69-1-62	1/15/69	380,533
1967	5,239,566	1,520,000	(2,647,039)6/	- 0 -	to '64 and '65				
1968	4,718,031	70,000	CLOSED						
1969	4,074,837	(2,378,394)7/	CLOSED						
Ozark									
1964	5,164,746	1,009,455	1,218,434	435,903	- 0 -	435,903	68-8-63	8/15/68	258,180
1965	5,520,325	546,000	1,013,438	336,292	(326,831)	336,292	69-1-129	1/30/69	86,980
1966	5,060,593	904,000	1,248,274	386,522	(386,522)	- 0 -	70-5-107	5/21/70	246,579
1967	4,347,147	1,342,000	1,292,160	233,739					
1968	3,634,541	(650,000)	(907,865)8/	- 0 -	to '65				
1969	2,807,600	(3,992,693)	-		to /65 and '66				
Pacific									
1964	3,694,207	1,361,526	1,278,895	362,792	(362,792)	- 0 -	70-7-73	7/15/70	8,915
1965	3,694,997	700,000	1,003,005	403,785	(403,785)	- 0 -	70-7-73	7/15/70	207,617
1966	3,594,860	28,000	(94,428)	- 0 -	to '64	- 0 -			Deficiency
1967	3,362,197	(3,716,000)	(4,345,151)	- 0 -	to '64 and '65				
1968(Bonanza & West Coast merged on 4/17/68 Became Air West)	10,288,771	(10,319,000)							
1969	9,445,804	(20,788,181)							
Southern									
1964	5,459,717	900,810	639,882	274,171	(274,171)	274,171	E-24649	1/18/67	537,190
1965	5,769,207	938,000	1,616,355	560,615	(560,615)	560,615	68-12-112	12/20/68	744,407
1966	4,540,967	860,000	1,389,129	648,876	(648,876)	648,876	69-3-75	3/20/69	82,267
1967	4,283,166	(159,000)	(605,009)	- 0 -	to '64				
1968	4,055,167	(332,000)	(1,555,000)9/	- 0 -	to '65				
1969	3,582,987	(821,927)	CLOSED						
Trans-Texas (Texas International)									
1964	5,817,991	939,207	832,641	365,774	(365,774)	365,774	E-25209	5/29/67	352,592
1965	6,406,158	595,000	1,171,271	533,803	(533,803)	533,803	68-11-15	11/4/68	774,572
1966	5,344,000	992,000	1,183,263	500,842	(500,842)	- 0 -	70-5-108	5/21/70	296,792
1967	4,440,792	(378,000)	(841,240)	-	to '64				
1968	4,037,352	(1,483,000)	(1,722,067)10/	-	to '65 and '66				
1969	3,332,175	(5,240,077)	(5,423,432)	-	to '66				

	Gross Subsidy	Net Income (Loss) Per Form 41	Net Income (Loss) Per Tax Return	Federal Income Taxes Paid	Refund from Carryback	Recognized for Profit-Sharing	Final Profit-Sharing Order Number	Date	Amount
West Coast									
1964	$5,229,110	(459,192)	$1,094,537)11/	- 0 -	- 0 -	(522,548)	Letter	1/6/67	Deficiency
1965	5,308,753	716,000	745,262	309,905	(309,905)	- 0 -	70-7-74	7/15/70	250,644
1966	4,975,727	795,000	1,707,385	773,227	(773,227)	- 0 -	70-7-74	7/15/70	630,233
1967	4,332,633	(400,000)	(2,436,553)	- 0 -	to '65 and '66				
1968(merged 4/17/68 Air West)	1,229,852	(275,000)	(11,089,720)						

1/ See footnote 5, Order 70-6-9.

2/In April 1968, Bonanza and West Coast were merged into Pacific which changed its name to Air West. Subsequent losses of Air West could not be carried back to recover Bonanza's taxes.

3/ Under the second provision in Section IIIE of Class Rate III-A, taxes paid in 1963 and recovered in 1965 were taken into income in 1965 because a final determination of 1963 profit-sharing had been made.

4/ In July, 1968 Lake Central merged into Allegheny. Subsequent losses of Allegheny could not be carried back to recover Lake Central taxes.

5/ Final determination was made before results were known for 1968. The 1967 NOL was carried first to 1964 with the balance to 1965; tax credit of $283,927 used in 1965.

6/ 1967 NOL carried back to 1964 and, in part to 1965; the 1965 case was closed prior to the required filing dates of the Form 41's and tax returns with the related authorities.

7/ Case closed prior to date results filed with Board.

8/ Case closed prior to date results filed with Board.

9/ Case closed prior to date results filed with the Board.

10/ Case closed before final results filed with the Board.

11/ 1961 taxes recovered by 1964 NOL carryback was taken into income for determination of carrier's profit for profit-sharing purposes.

Appendix C

Investigation of the Local Service Class Subsidy Rate, Order No. E-23850, June 23, 1966:

* * *

PROFIT-SHARING

II. The annual subsidy otherwise due and payable to each carrier pursuant to the terms, conditions and limitations of section I, above, shall be subject to reduction to the extent that the carrier's earnings for calendar year 1966 or any succeeding calendar year during which this rate is effective exceed the carrier's weighted average differentiated rate of return on investment, in accordance with the provisions set forth below.

In the event that this class rate terminates prior to the last day of a calendar year and is not superseded by a class rate containing profit-sharing provisions, the subsidy otherwise due and payable to each carrier pursuant to section I for any such period of less than a calendar year shall be subject to reduction in like manner; Provided that the results of the carrier for such period shall be adjusted to eliminate seasonal distortions.

A. Each carrier's weighted average differentiated rate of return shall be arrived at by applying rates of 16.00 percent, 7.50 percent, 6.50 percent and 5.75 percent to the common stock equity, preferred stock equity, convertible debenture and long-term debt components of recognized investment, respectively; Provided, however, that the differentiated rate of return computed in accordance with the preceding portions of this paragraph (1) shall not exceed 11.0 percent of total recognized investment (after applicable income taxes), and (2) shall not be less than the greater of 9.00 percent of total recognized investment (after applicable income taxes) or the equivalent of three cents (after applicable income taxes) per revenue plane mile flown (in accordance with the definition of revenue plane miles flown as defined in section I F (1), above).

B. In any case where a carrier's annual earnings (after applicable income taxes) exceed its weighted average differentiated rate of return, such carrier shall refund a portion of such profits, to the extent indicated in the table below, to the Board as subsidy not due the carrier:

Rate of Return (After Taxes)	Percentage of Profits Refunded by Carrier
0% to D[10/]	0%
D to 13.5%	50%
Over 13.5%	75%

10/ D represents the fair and reasonable differentiated rate of return, not to exceed a maximum of 11 percent, and not less than a minimum of 9 percent.

The refund otherwise due and payable to the Government pursuant to this section shall be increased by the amount of the income tax savings estimated to accrue to the carrier as the result of such refund.

III. In applying the provisions of section II, above, the revenues and other income items, expenses, investment and income taxes shall be determined in accordance with the provisions of this section III.

A. Revenues

1. The revenues shall be those reported by each carrier on its Form 41 reports to the Board, provided that such reports are consistent with the reporting requirements of the Act and the Board's Regulations (particularly the Uniform System of Accounts and Reports, Part 241 of the Board's Economic Regulations) and that such reports reflect accounting practices consistent with the carrier's practices and reports for prior periods, except in cases where the carrier obtains, in the final computation under this section III, Board approval of a change for purposes of this order.

2. The revenues reported but not complying with 1, above, shall be adjusted to comply therewith in applying the provisions of II, above.

3. Revenues reported from each nontransport activity, considered separately, or from transactions with each affiliate shall be excluded unless the profit (after income taxes) to the carrier from each such activity exceeds the differentiated rate of return for the carrier for air transport operations, in which case such excess shall be utilized for the purpose of II, above. For the purpose of this entire section III, the term affiliate (or affiliated) shall be deemed to include any "associated company" as defined in Section 03 of the Uniform System of Accounts, or any relationship defined as "affiliated" in Sec. 261.8(b) of the Board's Economic Regulations, as amended.

B. Operating Expenses

1. The operating expenses shall be those reported by each carrier on its Form 41 reports to the Board, provided that such reports are consistent with the reporting requirements of the Act and the Board's Regulations (particularly the Uniform System of Accounts and Reports, Part 241 of the Board's Economic Regulations) and that such reports reflect accounting practices consistent with the carrier's accounting and reports for prior periods, except in cases where the carrier obtains, in the final computation under this section III, Board approval of a change for the purpose of this order, and, provided further, that reporting and accounts not complying with this paragraph 1, shall be adjusted to comply therewith in applying the provisions of II, above.

2. The operating expenses otherwise reported or determined in accordance with paragraph 1, above, shall be subject to the conditions set forth below.

3. Non-allowable expenses - The following expense items shall not be recognized and shall be disallowed:

a. Any expense related to fraudulent activities or otherwise arising from actions prohibited by the Act, or any other provision of law, or regulation of the Board or other agency of the Government;

b. Fines or other similar penalties accrued, or paid, as the result of violation of law or in violation of any association rule or by-law;

c. All financing costs and costs related to financing;

d. Lobbying costs;

e. Compensation, in any form whatsoever, paid directly or indirectly to or on behalf of (1) each carrier's chief executive officer at a rate in excess of $35,000 per annum, or (2) any other officer, director, or employee of the carrier at a rate in excess of $25,000 per annum;

f. Any payment made directly or indirectly, in any form whatsoever, to or on behalf of any officer, director, or employee of the carrier, or to or on behalf of any stockholder owning in excess of a one percent stock interest, to the extent that such payment exceeds the reasonable value of the goods or services received;

g. Any payment to directors, officers, or employees in the nature of bonuses related to profits or representing a sharing of profits;

h. Any form of dues (including initiation fees) expended on behalf of the carrier or any officer or director, unless such dues are for membership in a business, professional or trade organization;

i. Expenses incurred or accrued for route proceedings in which the carrier is an unsuccessful applicant, or is an intervenor, or participates pursuant to Rule 14 of the Board's Rules of Practice;

j. Expenses incurred or accrued for witnesses other than the carrier's personnel or consultants hired by the carrier;

k. Contributions for charitable or similar purposes;

l. Premiums for life insurance on the life of any person where the company is a named beneficiary; Provided, however, that the proceeds of such life insurance shall not be considered revenue of the carrier for the purposes of this section III;

m. Expenses incurred in non-transport activities except to the extent that such expenses are offset against revenues from such activities in accordance with III A,3, above;

n. Any expense related to stock options granted to employees where the amount charged is based on the difference between the option price and the market value of the stock;

o. Any other expense which is not reasonably related to the air transport services of the carrier.

4. The following expenses shall be capitalized, deferred and recognized in accordance with the provisions set forth below: 11/

a. Expenses incurred or accrued by a carrier for proceedings involving the issuance, alteration, amendment, modification or suspension of authority granted by the Board in a certificate of public convenience and necessity or exemption and for preparation for the operation of new routes or authority pursuant to such Board action shall be capitalized and held in suspense until the date that the authority is implemented by the carrier.

b. Expenses incurred or accrued for projects involving the integration of new types of aircraft or services or other preparations for alterations in operational characteristics and those projects of a non-recurring nature shall be capitalized and held in suspense until completion of the project.

11/ Notwithstanding the provisions of subsections a and b, of this section, where the Board, prior to January 1, 1961, has established a final subsidy rate which would otherwise be applicable on and after January 1, 1961, amortization shall be recognized on the basis set forth in such final rate order.

c. Subject to the other provisions of this section III, and particularly section III B 3 j, the expenses detailed in subsections 4 a and b, above, shall be recognized as follows: (1) where the amount capitalized is $5,000 or more it will be recognized by amortization over a period of five years, or, in the case of a new route award of less than five years' duration, by amortization over the duration of the route award, such amortization to commence on the date of the implementation of the new authority by the carrier or on the date of the completion of the project; or (2) where the amount capitalized is less than $5,000 it will be recognized as a charge to expense as of the date of the implementation of the new authority or completion of the project.

5. Accruals to obsolescence and deterioration reserves for flight equipment spare parts shall be recognized only to the extent indicated below:

a. The accrual for flight equipment spare parts shall be recognized insofar as it does not exceed one percent per month for DC-3 parts, one-half of one percent per month for other piston and turbo-prop parts, and one-third of one percent per month for turbo-jet parts, of the value of the inventory properly recorded in Account 1310.

b. The maximum reserve accrual to be recognized shall be 50 percent of the applicable inventory properly recorded in Account 1310. Charges to expense resulting from increasing the reserve accrual above 50 percent shall not be recognized.

6. The following expenses shall be recognized to the extent indicated below:

a. Expenses incurred by the carrier in dealings with an affiliate (including a separately operated division) shall be recognized only to the extent that the charges by the affiliate do not exceed cost plus a proper share of overhead, including a capital cost (at a level not in excess of the air carrier's own differentiated rate of return) and applicable income taxes;

b. Subject to the other provisions of this section III, and particularly section III B 3 a, costs which result from transactions not at arm's length or from dealings involving conflicts of interest shall be recognized only to the extent that they do not exceed reasonable levels;

c. Expenses incurred in connection with property sales and lease-backs involving such property or similar property shall be recognized only to the extent that they do not exceed the expenses which the carrier would have incurred if the transaction had not been entered into.

7. The depreciation expense to be recognized for flight equipment (including hulls and all related flight components) shall be subject to the following additional special rules and conditions:

a. The minimum service lives and residual values to be recognized for flight equipment (including hulls and all related components) shall be as set forth in the following table:

Equipment Type	Service Life	Residual Value
DC-3	3 years	10%
All other piston-powered aircraft	7 years	15%
Turbo-prop aircraft	10 years	15%
Turbo-jet aircraft	12 years	15%

b. The service life of each aircraft type shall be deemed to commence as of the date of its introduction into regularly scheduled service. The remaining service life for aircraft placed into service prior to January 1, 1961, shall be computed by subtracting from the years of service life assigned by the carrier, 12/ the service life expired prior to January 1, 1961, for which depreciation has been accrued by the carrier for such flight equipment;

c. For flight equipment acquired and placed into service prior to January 1, 1961, the recognizable expense shall be based on the remaining depreciable value recorded as of December 31, 1960, provided that such value does not exceed the depreciated original cost of such equipment to the air carrier; 13/

d. For flight equipment acquired and placed into service on or after January 1, 1961, the recognizable expense shall be based on the depreciable original cost of such equipment (including capitalized interest) to the carrier;

e. The cost of any flight equipment improvements, additions, or betterments shall be capitalized and, upon completion of the modification, such cost, less residual value, 14/ shall be recognized as depreciation over

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12/ Subject to the minimum service lives as set forth in section III B 7 a, above.

13/ Where a final subsidy rate has been established for a carrier applicable to a period prior to January 1, 1961, the remaining depreciable value recognized for the purposes of this Order shall not exceed the cost based on depreciable value and depreciation rates recognized in such final order (or orders).

14/ For the purposes of this section the residual value to be recognized will be determined by multiplying the total modification cost by the applicable residual value percentage for the type of equipment modified as established in section III B 7 a, above.

the remaining depreciable life (as determined in accordance with the other provisions of this section III B 7) of the flight equipment modified; Provided, however, that where such improvements, additions, or betterments increase the original cost of the equipment modified by 10 percent or more, such modification cost shall be recognized as depreciation, along with the remaining undepreciated cost of the equipment modified, over the remaining depreciable life of the equipment modified or three years, whichever is greater, unless prior Board approval, for the purposes of this order, of an alternative plan has been obtained by the carrier; Provided, further, that the cost of equipment, such as Distance Measuring Equipment (DME) and transponders, shall not be considered flight equipment improvements, additions or betterments for depreciation purposes under this section III B 7 e but shall be depreciated independently on the basis of the respective service lives and residual values (as set forth in section III B 7 a) for the equipment type on which they are installed; Provided, further, that the cost of equipment modifications which result in an essential change in the character of the equipment modified, such as the conversion of a Convair 340 to a Convair 580, do not fall under the purview of section III B 7 e, but shall be depreciated, from the time of its entry into useful service, over the entire applicable service life for its new type as specified in section III B 7 a

f. The remaining depreciable value derived under subsections c, d, and e, above, shall be spread out equally each month over the remaining service life derived under subsections a, b, and c, above.

g. For the purpose of this section III B 7, the otherwise recognizable depreciable cost for aircraft hulls and engines shall be

reduced by the value of the "built-in-overhaul", such value to be determined at a reasonable level consistent with prior and anticipated experience; Provided, however, that where aircraft are maintained on a "block" overhaul basis, the depreciable cost shall be reduced by an amount equal to the value of the overhaul remaining at run-out-time 15/ before the block overhaul is performed, plus an amount representing the value of the hours remaining at acquisition to the next block overhaul, 16/ regardless of whether the required overhaul procedures are completed in one stage or in multiple stages within the authorized block; Provided, further, that where aircraft are maintained on a "continuous" overhaul basis, the depreciable cost shall be reduced by 50 percent of the value of the "built-in-overhaul".

8. The cost of any improvements, additions, or betterments to leased property or equipment shall be capitalized, and such cost will be recognized as depreciation, as a minimum, over the expected rental life of the equipment or property modified or over the useful life of the modification whichever is shorter, unless prior Board approval, for the purposes of this order, of an alternative plan has been obtained by the carrier.

9. Unless otherwise approved by the Board, for the purposes of this order, the minimum service lives and residual values to be recognized in determining depreciation expense for ground property and equipment (computed on a straight-line basis) shall be consistent with those recognized by the Internal Revenue Service for such property and equipment.

15/ In a four block overhaul this would be expressed as 37 1/2 percent of the estimated "one-shot" overhaul cost. The run-out percentage for a five block overhaul would be 40%, for six - 41 2/3%, etc.

16/ Determined by: (a) dividing the estimated "one-shot" overhaul cost by the total authorized hours; and (b) applying the rate per hour determined in (a) to the block overhaul hours remaining at acquisition.

10. Maintenance charges will be recognized consistent with the built-in-overhaul principle of amortization of overhaul costs. Accruals to a reserve for future overhauls and overhauls expensed on a cash basis will not be recognized. However, where overhauls are maintained on a "continuous" basis, cash expensing of each overhaul procedure will be recognized if the charges to expense for each accounting period approximate those charges which would have obtained under the overhaul amortization principle.

C. Investment

1. Subject to the same requirements as to compliance with the Act and the Board's Regulations, as set forth in III A and B, above, the investment shall be the average of the balance sheets reported for the four quarters of the calendar year, for which section II, above, is being applied, and the year-end balance sheet for the immediately preceding year, with one-half weight accorded the opening and closing balance sheets.

2. The investment shall be subject to the additional special rules and conditions set forth below:

a. Notes payable due beyond three months shall be treated as long-term debt;

b. Non-operating property shall be excluded;

c. The air carrier's investment in any affiliated or non-transport activity shall be recognized only in the event that the profits (after income taxes) reported by the air carrier from such company or activity exceed the weighted average differentiated rate of return of the air carrier and such profits are utilized to reduce the air carrier's subsidy otherwise payable under section I.

d. The investment shall not include the cash or other value of any life insurance policy purchased by the carrier;

e. The investment shall not include equipment replacement funds derived from sale of flight equipment, but such funds shall be recognized only when re-invested in property which is productive in the carrier's transport operations;

f. The investment shall not include equipment purchase deposits, capitalized organizational expense, capital stock expense, unamortized discount and expense on debt, or funds restricted as to general availability by management decision or otherwise;

g. Sums capitalized and held in suspense pursuant to section III B 4 a and b, above, will not be included in investment during the deferral period; however, capitalized interest on such sums, at a 5.75 percent rate, will be recognized if the expenses are recognizable under other provisions of this order;

h. Credits to Account 2290 of the Uniform System of Accounts and Reports will not be recognized for investment purposes;

i. Investment represented by receivables not due and paid within one year from officers and directors of the carrier will be recognized only if such receivables yield a return, after taxes, equal to, or in excess of, the weighted average differentiated rate of return for the carrier;

j. Working capital 17/ in excess of the equivalent of three months' operating expenses, exclusive of depreciation and amortization, shall be excluded;

k. Reserves accrued through charges to operating expense (except depreciation, airworthiness and other valuation reserves) will be treated as current liabilities for investment purposes;

l. Debt investment shall be adjusted to exclude costs related to (1) construction work in progress, (2) property and equipment acquisitions, and (3) substantial equipment modifications, such as conversion of presently owned aircraft to turbo-prop aircraft, prior to their entry or re-entry into useful service, properly recorded in Accounts 1601-1608, 1630-1640 and/or 1689; however, capitalization of interest on such excluded costs will be recognized at a 5.75 percent rate.

m. In computing working capital for periods commencing January 1, 1966, accruals of subsidy payable for each balance sheet date shall be made pursuant to the rate established by this Order; Provided, however, that where a mail rate period is open prior to January 1, 1966, such working capital shall reflect the subsidy payable to the air carrier pursuant to the most recent Board order fixing the carrier's subsidy rate for such period.

n. Where assets which are related directly to entries in Accounts 2250 and 2260 of the Uniform System of Accounts and Reports are excluded from investment pursuant to the provisions of sections III C, and III F of this order, the adjustment to investment shall be made against equity capital.

17/ For the purpose of this order "working capital" is defined as the excess of current assets as specified in Accounts 1010 through 1420 and Account 1890 of the Uniform System of Accounts and Reports, over current liabilities as specified in Accounts 2010 through 2190 and Account 2390; provided, however, that current liabilities shall not include that portion of notes payable recorded in Account 2010 due beyond three months.

D. Other Income and Non-operating Expenses - In applying section II, above, all income to the carrier (except subsidy applicable to prior periods and capital gains on flight equipment qualifying pursuant to section 406(d) of the Act and the Board's Regulations, thereunder) shall be included whether such income is recorded as revenue, non-operating income and/or special income; but no non-operating expenses shall be recognized except capital losses on ground equipment.

E. Income Taxes

1. Federal and State income taxes shall be determined on the basis of the carrier's actual income taxes, including the reduction of taxes resulting from loss carrybacks and carryovers, as reported on its income tax returns submitted to taxing authorities for each year, with such amendments and revisions as may have been filed as of the final determination of profit-sharing hereunder; Provided, however, that, for the purposes of this order, the carrier's actual income taxes for a given review year will be adjusted to exclude taxes related to income which is not otherwise considered in the profit-sharing determination, hereunder, for that review year; Provided, further, that where a final profit-sharing determination for a prior period has been made and the tax basis relied upon in that final determination has been amended or revised subsequently, the effect of the change in taxes will be considered as income or expense for profit-sharing purposes in the year in which the change is made; and Provided, further, that to the extent investment tax credits derived under section 38 of the Internal Revenue Code of 1954, as amended, are directly utilized to reduce federal income taxes for the calendar year 1966 and/or succeeding years during which Class Rate III-A may be effective, such credits will be ignored for profit-sharing purposes

hereunder in the absence of specific consent by the carrier to other treatment in determinations hereunder for 1966 or succeeding years. 18/

2. Carriers whose tax returns are filed for a 12-month period not coinciding with a calendar year shall submit a pro forma tax return for the calendar year, which return shall be prepared on bases consistent with the returns of that carrier filed for the last fiscal year with the appropriate tax authorities. 19/

F. Where an adjustment is required and effective pursuant to the provisions of paragraph III A, or B, or C, or D, or E, above, such appropriate adjustments shall be made for the purpose of all other provisions of this section III, where sound accounting practice and consistency so require.

G. The filing of plans or other submissions under section 22(d) of the Uniform System of Accounts and Reports or any other provisions of this order shall be made with the Board's Bureau of Accounts and Statistics, but such plans and submissions shall not be deemed approved, for the purposes of this order, in the absence of affirmative written Board approval.

IT IS FURTHER ORDERED, That the compensation provided herein shall be in lieu of, and not in addition to, the mail compensation heretofore received by the carriers named herein for mail transported over each of their entire systems on and after January 1, 1966.

18/ Tax credits carried back to 1964 and/or 1965 will be utilized in reduction of taxes for those years for profit-sharing purposes under Class Rate III.

19/ A reconciliation of such pro forma return with the carrier's reported operating results will be required.

IT IS FURTHER ORDERED, That this order shall become effective on June 30, 1966, unless prior to that date exceptions with respect to the modifications made herein together with supporting reasons have been filed with the Board by any party named herein. If exceptions and supporting reasons are filed within the prescribed time, the effective date of this order shall be stayed pending further action by the Board.

MURPHY, Chairman, MURPHY, Vice Chairman, MINETTI, GILLILLAND and ADAMS, Members, concurred in the above Statement and Order.

HAROLD R. SANDERSON

Secretary

(SEAL)

REPLY BRIEF OF PETITIONER TEXAS INTERNATIONAL AIRLINES, INC.

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

TEXAS INTERNATIONAL AIRLINES, INC., Petitioner	:	
v.	:	No. 24,459
CIVIL AERONAUTICS BOARD, Respondent	:	

On Petition for Review of an Order of the Civil Aeronautics Board

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IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

TEXAS INTERNATIONAL AIRLINES, INC., Petitioner v. CIVIL AERONAUTICS BOARD, Respondent	No. 24,459

REPLY BRIEF OF PETITIONER TEXAS INTERNATIONAL AIRLINES, INC.

I. INTRODUCTION.

Respondent Civil Aeronautics Board (the Board) has not actually responded to the claim of discrimination in the administration of the Board's 1966 subsidy program for local service air carriers which is the basis of this petition for review of Texas International Airlines, Inc. (Texas International). In its initial Brief, Texas International showed that the Board had erred in granting an allowance for Federal income taxes to other carriers it did not grant to Texas International in the same circumstances, thereby discriminating against Texas International. The responding Brief of the Board recognizes and concedes the disparity of treatment alleged, but it does not recognize that the disparity was in the administration of

the subsidy program, and fails to deal with the actual point on review.

The Board contends instead that the discriminatory result is the product of "even-handed" application of a discriminatory formula. Thus, the Board simply assumes the accuracy of its position as to the point really in dispute, and goes on to argue questions which are not the subject of contention. In particular, the Board's contention that Texas International is challenging the rate formula is not only wrong, and irrelevant, but seems to be an attempt to shift the responsibility for the discriminatory result to Texas International for agreeing to a rate formula which could be arbitrarily and discriminatorily applied.

In its failure to deal with the actual arbitrariness alleged, the Board fails also to address itself to the cases cited by Texas International showing that such discrimination requires a reversal of its decision. Additionally, the Board perhaps is not clear that there are two arbitrary and unnecessary discriminatory determinations involved: (1) the determination to require any refunds for Texas International for 1968 and 1969 net operating loss carrybacks from Texas International which were not required from other carriers, and (2) the application to Texas International as to the 1969 carryback of a novel theory of future recapture which was not applied to other carriers. The Board's treatment of the two points is inconsistent. For all these reasons, the Board's Brief leaves Texas International's

basic proposition unanswered, and establishes that reversal of the Board's decision is required.

II. THE ISSUE IN THIS CASE IS THE BOARD'S DISCRIMINATION AGAINST TEXAS INTERNATIONAL IN THE ADMINISTRATION OF ITS SUBSIDY PROGRAM.

Texas International seeks review here of the Board's administration of its subsidy program. Specifically Texas International demonstrated in its Brief that the Board, in requiring Texas International to refund subsidy allowances which other carriers similarly situated were allowed to keep, discriminated against Texas International. Appendix B to the Brief of the Board indicates that Frontier Airlines, Inc. received a refund for 1966 Federal income taxes, due to net operating loss carrybacks, of $806,444, and that Frontier was not required to refund any of this amount to the Civil Aeronautics Board. Similarly, the Board's Appendix B shows that North Central Airlines, Inc. received 1966 Federal income tax refunds of $764,367, that North Central was not required to refund any of this to the Civil Aeronautics Board, that Southern Airways, Inc. received 1966 Federal income tax refunds of $648,876, and that Southern was not required to refund any of this to the Civil Aeronautics Board. 1/ The Board's Brief further concedes that Mohawk Airlines, Inc. would have been allowed to keep such refunds had it paid 1966 taxes which would be refunded (Board Br. 21 n. 26). Texas

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1/ The Board's Appendix B does not indicate what proportion of these refunds was due to 1968 net operating losses and what proportion to 1969.

International, on the other hand, has been required to refund to the Board subsidy payments of $296,792 due to 1966 Federal income tax refunds (Board Br. 2).

Despite these admissions the Board's Brief contends that "in every instance carriers situated the same have been treated the same" (Board Br. 21), that the Board "treated all carriers similarly situated in the same fashion" (Board Br. 20), and that "the formula was applied even-handedly" (Board Br. 15). See also Board Br. 12. Thus the Board's Brief consistently resists recognizing the differentiation which it acknowledges exists, and which even the Board's opinion under review admitted. Order 70-3-92, p. 10 (J.A. 23). This differentiation, or discrimination, was entirely avoidable and unnecessary. In failing to recognize that this is the issue, the Board's Brief is not responsive.

Where the Board does deal with Texas International's claim of arbitrary and unnecessary discrimination in the administration of the subsidy program, the Board misstates the issue. Thus the Board says that "Texas International contends that the treatment of 1968 loss carrybacks in Frontier's 1966 profit-sharing was different from the manner in which its profit-sharing was treated and that such differences were not due to timing alone, but to a decision in principle not to capture the company's 1968 loss carryback. Petitioner characterizes this as an arbitrary and capricious discrimination by the staff." (Board Br. 21-22). This statement is wrong. Texas

International does not characterize the decision to allow Frontier to keep its net operating loss carryback refund as an arbitrary and capricious determination; Texas International challenges the Board's decision not to allow Texas International to keep its net operating loss tax carryback refunds where it had previously allowed Frontier to do so as an arbitrary and capricious determination. This is the crux of the case, and the Board's Brief fails to deal with it.

* * *

It is necessary to comment on the Board's mischaracterization of the issue of non-discriminatory treatment for Texas International as a request for "excessive profits" (Board Br. 2). First, as Texas International pointed out in its Brief (p. 25), it ill suits the Board to characterize a payment that it has found fair for some carriers as "excessive" for another carrier similarly situated. Second, since the Board has chosen to raise equitable considerations, it should be noted that the real situation here is one of enormous losses in 1968 and 1969 for the entire local service carrier industry (Texas International Br. 4-6). These losses would seem to indicate a failure of the Board's subsidy program in those years to compensate the carriers adequately for their operations.[2/] The Board, as the regulator of the air transportation industry, was well aware of these

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2/ As the Board's Brief has pointed out, the class rate is now under revision again. Investigation of Local Service Class Subsidy Rate (Class Rate V), Order 70-7-148, July 31, 1970 (Board Br. 7).

losses at the time, or certainly should have been (Texas International Br. 4-6, 13, 16-17). The Board presumably had these extraordinarily large losses in mind when it allowed the first carriers whose subsidy it "closed" to keep any tax refunds they might obtain on account of these losses. It is the Board's failure to provide comparable treatment here which is challenged. Comparable treatment will leave Texas International with a multi-million dollar loss for 1968 and 1969 -- there is no question of "excessive profits". Finally, in this connection, it should also be noted that the tax refund involved is a Federal income tax policy to recognize losses incurred by a corporation -- here Texas International in the years 1968 and 1969 -- and not a contribution to "profit". The Board's characterization of the issue is unjustified.

III. THERE ARE TWO SEPARATE ELEMENTS OF DISCRIMINATION INVOLVED.

It appears in places in the Board's Brief that the Board does not recognize the two separate aspects of arbitrary and discriminatory decision-making involved here. For a proper analysis it is necessary to distinguish between the two.

(1) As to the 1968 and 1969 net operating loss carryback tax refunds, which the Board required Texas International to refund to it, the Board unnecessarily and arbitrarily discriminated against Texas International in requiring these refunds when other carriers, specifically Frontier Airlines, Inc. and North Central Airlines, Inc.,

had previously been allowed to keep comparable refunds. The discrimination here was in the timing and means of the Board's closing out of the rates for the various carriers, and was wholly avoidable. The Board could have arranged the closing out of the rates for all carriers as to tax refunds in such manner that all carriers were treated alike. Its failure to do so was an arbitrary discrimination against Texas International.

(2) As to the 1969 net operating loss tax refund only, the Board further arbitrarily and unnecessarily discriminated against Texas International in that it applied a novel theory of future recapture of a tax refund not yet applied for, much less received, and required Texas International to refund this sum. This by the Board's own admission is a departure from its "actual tax policy" (Order 70-3-92, pp. 8-9 (J.A. 21-22); Board Br. 17). In its treatment of other carriers (Frontier, North Central, Southern and Mohawk) under this Class Rate the Board had not adopted such a policy of future recapture, despite the clear evidence of prospective operating losses which was in the Board's hands when their 1966 subsidy computations were closed. Indeed, it now appears that the Board may have selected the date for its opinion requiring Texas International to pay the Board its prospective 1969 net operating loss carryback in order to support the novel theory of future recapture that it has adopted, and even on the Board's theory, had the Board issued its opinion on this subject three days earlier, Texas International would have had to be treated

the same as the four named carriers. This novel treatment of Texas International constituted an entirely separate arbitrary discrimination, reversible pursuant to the terms of the Administrative Procedure Act and the due process provisions of the Constitution.

IV. TEXAS INTERNATIONAL DOES NOT CHALLENGE THE FORMULA OF CLASS RATE III-A.

The Board dedicates the Introduction to its Argument, and parts of the Argument itself, to answering a contention that Texas International is challenging the formula of Class Rate III-A (Board Br. 12-15, 16, 28). This contention is of the Board's own devising. Texas International makes no such challenge.

Texas International believes that both it and the Civil Aeronautics Board are bound by the terms of Class Rate III-A, and it is the Board's uneven administration of that rate pursuant to its authority which was in error. Thus all the Board's cases on the finality of rates are irrelevant to this proceeding, as is the Board's reliance on the point that this claim was not raised before the Board. Indeed, if Texas International were making the challenge the Board says it is, the Board's response in its Brief would fail because there is no adversion to this theory in the Board orders on review (Order 70-5-108 (J.A. 27); Order 70-3-92 (J.A. 13)). Northeast Airlines, Inc. v. CAB, 331 F.2d 579 (1st Cir. 1964). The Board's defense of the integrity of the rate formula has nothing to do with this appeal.

V. THE BOARD WAS NOT REQUIRED TO DISCRIMINATE AS IT DID.

A. As to 1968 and 1969

The Board concedes that Frontier, North Central, and Southern were allowed to keep Federal income tax refunds occasioned by 1968 and 1969 net operating losses, and that Texas International was not (Board Br. 21, App. B). The Board argues that this disparity of treatment was in fact "even-handed" (Board Br. 20) because it arose from the Board's decision to close the subsidy rates of the different carriers at different times, and was therefore a required discrimination.

As Texas International pointed out in its initial brief, this discrimination was in no sense mandatory (Texas International Br. 14-19). Nor is it appropriate to treat it as some sort of accident of time. The Board could have treated all carriers alike. The record shows that the Board was processing the profit-sharing of Texas International at the same time as that of the other carriers (Texas International Br. 8-13). It was evident by the time the Board started "closing" the first subsidy claims that all carriers were going to have substantial operating losses in 1968 (and ultimately in 1969) (Texas International Br. 4-6, 13). When the Board made its determination that it would allow Frontier and North Central to keep the refunds they would have from their 1968 losses, it could have made the same decision as to all other carriers, either by closing their rates entirely, or by closing

them only as to taxes.[3] Conversely, the Board could have kept the rates for Frontier and North Central open until a later date and required them, as it ultimately required Texas International and other carriers, to refund subsidy on account of these 1968 and 1969 tax refunds.

Both in its order on review, and in its brief on appeal, the Board has simply failed to deal with the choice it had in the administration of the subsidy program as to these tax refunds.[4] It argues instead that it was required to discriminate by the terms of the formula, but it has failed to show how this is so. The Board's contention as to this point is that it had no discretion whatsoever in the administration of the subsidy function (Board Br. 12-15, 29, 31). On the other hand, to develop the novel theory of future carry-back recapture applied to Texas International's 1969 net operating losses, the Board argues that it has discretion to interpret the subsidy formula as it wishes, and that its interpretation is to be respected by the court as administrative expertise and a valid

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3/ The Board has frequently closed a part of a rate for profit-sharing purposes while discussing the remainder with the carrier. Order 68-12-125, December 23, 1968, pp. 6, 8 (Mohawk-1965); Order E-26396, February 23, 1968 (North Central-1965); Order E-25209, May 29, 1967 (Texas International-1964); Order E-24649, January 18, 1967 (Southern-1965).

4/ The Board has treated the point that it had a choice as a contention that the rates should be kept open indefinitely, but of course this is not the same thing, and no such contention is made. Cf. Order 70-3-92, p. 10 (J.A. 23); Board Br. 24.

exercise of discretion (Board Br. 18-19). Furthermore, the Board argues that both discriminations are merely accidents of timing, which it contends is entirely a matter for the Board's discretion (Board Br. 25-26). The Board cannot argue discretion both ways, and its attempt to do so effectively undercuts its claim that the discrimination was required.

In fact, the Board had options here which permitted it to provide equal treatment to all carriers, and it failed to exercise them. This failure is one element of the discrimination which is present here, and it is applicable to the Board's recapture of refunds due to both the 1968 and 1969 net operating losses of Texas International.

B. As to 1969 only

The Board's claim that the discrimination is required by the Class Rate III-A formula has no impact on the further discrimination perpetrated by the Board as to Texas International's 1969 net operating loss carryback refund claim, which arose from a discriminatory interpretation of the formula. The formula expressly provides that

> "Federal and State income taxes shall be determined on the basis of the carrier's actual income taxes, including the reduction of taxes resulting from loss carrybacks and carryovers, as reported on its income tax returns submitted to taxing authorities for each year, with such amendments and revisions as may have been filed as of the final determination of profit-sharing hereunder. . . ." Order E-23850, June 23, 1966, p. 22 (emphasis added).

This formula has never before been interpreted by the Board to provide for adjustment of taxes for returns which had not been filed as of the

date of the determination. Thus, as to the 1969 net operating loss carryback refund claims, the Board discriminated against Texas International not only in that it required any refund, but in requiring a refund based on a prospective refund claim.

Texas International's situation in early 1970 as to its 1969 net operating loss was precisely the same as, for example, Frontier's situation in early 1969 as to its 1968 operating loss. The Board did not attempt to recover from Frontier a net operating loss tax carryback refund for which Frontier had not applied, but it now contends that it should recover such a refund from Texas International. The Board has discriminated against Texas International by refusing to apply the "actual tax policy" that it stresses that it applied to Frontier.

As to this further discrimination, the Board makes three contentions.

First, the Board says, when Frontier's rate was closed on January 24, 1969 (Order 69-1-99, J.A. 1), Frontier had only filed formal financial reports with the Board for the first three quarters of 1968, and while the loss for these three quarters was $3,700,000 (Texas International Br. 17-18), the Board could not be absolutely certain that a loss was actually incurred for the year (Board Br. 22).

Frontier expressly told the Board, in a memorandum filed November 6, 1968, that "The Board is aware that Frontier has suffered sizeable operating losses for 1968 and that it is diligently seeking ways to

to recover from these losses." (J.A. 49). The Board was well aware that these losses could not and would not be overcome in the fourth quarter,[5/] and for the Board to say that the loss might have been offset by equipment transactions, merger, or acquisitions (Board Br. 22), without the Board's knowledge, in view of the fact that the Board is charged by law with regulating such things,[6/] is a naive suggestion indeed. At the very least, because a loss actually was incurred, had the Board been interested in knowing whether Frontier would have a net operating loss carryback refund because of its 1968 results, all it would have had to do was ask Frontier.

Second, the Board tries to obscure the fact that it did have knowledge, before it closed out Frontier's subsidy in 1969, of Frontier's 1968 net operating loss by comparing a November 1968 date when the Board alleges its staff and Frontier "agreed" on a method of computation of subsidy for Frontier with the actual May 1970 order date for the refund of such subsidy by Texas International (Board Br. 22-23). No such "agreement" is shown in the record, and even if it were, it would be irrelevant. The record shows that Texas International and the Board's subsidy staff agreed on all elements of Texas International's subsidy except 1968 tax loss carrybacks on June 26, 1969, nine months before the date on which the Board relies in its attempt to recapture

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5/ Frontier had annual revenues of about $69,000,000 at this point. Frontier Form 41, filed November 8, 1968 (J.A. 56).

6/ Federal Aviation Act of 1958, § 406, 49 U.S.C. § 1378.

subsidy because of Texas International's 1969 net operating loss (J.A. 80). Thus Texas International stood in at least as good a position in June 1969 as to its 1969 net operating loss carryback as Frontier stood in November 1968 as to its 1968 net operating loss carryback. If "agreement" dates are determinative, Texas International clearly is not obligated to return additional subsidy even if the rest of the Board's future recapture theory is valid. 7/

The Board's third contention is that Texas International's situation is fundamentally different from that of the four carriers (Frontier, Mohawk, North Central and Southern) whose subsidy it had disposed of previously because Federal income tax returns for 1969 were due on March 16, 1970, 8/ unless the corporation availed itself of the automatic extension provisions of the Internal Revenue Code. 9/ Thus, says the Board, while Texas International had not filed any return or claim for a tax refund on account of its 1969 net operating loss, so that it did not come under the terms of the Class Rate III-A formula, it should be treated as though it did. In other words, the Board says, Texas International's "need" as computed under Class

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7/ The Board's point that Texas International had previously had the same treatment as to net operating loss carrybacks for its 1965 profit-sharing as Frontier received as to 1966 (Board Br. 23-24) of course simply emphasizes the departure from prior practice made by the Board as to Texas International for 1966.

8/ March 15, 1970 fell on a Sunday.

9/ Internal Revenue Code § 6081, 26 U.S.C. § 6081.

Rate III-A was in effect reduced $200,000 by the passage of the March 16 paper date and the Board's issuance of its opinion on March 18 (Texas International Br. 12). The Board provides no legal support for this contention.

Furthermore, the Board's efforts in its Brief (p. 18) to infer an improper motivation on Texas International's part in its use of the well-known and much-applied automatic extension provided for corporations in Section 6081 of the Internal Revenue Code (26 U.S.C. § 6081) are inappropriate. There is no indication that Texas International sought its automatic extension in 1970 in order to avoid a refund of subsidy. 10/ Indeed, Texas International had no way of knowing in advance that two days after the paper filing date of March 16 the Board was going to adopt the novel theory that a refund of subsidy was required because that date had passed and despite the fact that such a refund had not been sought from other carriers similarly situated. Certainly the fact that Texas International applied for an automatic extension is no justification for a discrimination between Texas International and Frontier, North Central and Southern as to the subsidy payment allowed.

10/ Texas International had a similar extension in 1969 (Texas International Br. 10).

VI. THE BOARD'S DISCRIMINATORY DECISION-MAKING IS NOT JUSTIFIED BY PRECEDENT.

In its Brief, Texas International set out several cases demonstrating that it is legally unacceptable for an administrative agency to discriminate between comparably situated parties by reaching opposite results in the same situation (Texas International Br. 20-24). These cases demonstrate that the Board's failure to treat Texas International like other carriers was "arbitrary and capricious" within the meaning of the applicable law and must be reversed.

The Board's Brief does not even address itself to these decisions, except on the last page, where it says that they are to be distinguished because these are precedents in the "area" of "discriminatory decision-making" and the instant decision "is not a ratemaking decision" (Board Br. 31). This analysis is unintelligible. The Board can scarcely deny that the order on review constitutes a decision,[11/] and that the Board is required in its decision-making to abide by the standards of the Administrative Procedure Act and constitutional due process. Whether "ratemaking" is involved is irrelevant.

Furthermore, the Board's characterization of these cases as "only cases in which the agency was making a rate or route determination with freedom to change its policies so long as it explained its position" (Board Br. 31) is erroneous, and irrelevant as well. These cases cannot

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11/ Indeed, the Board has conceded as much by admitting jurisdiction here.

fairly be so described. Cf. FCC v. WOKO, Inc., 329 U.S. 223 (1946). All of them are cases of inconsistent treatment of parties similarly situated. These cases, accurately described in Texas International's Brief, speak for themselves and need no further discussion here. They require that the Board's inconsistent treatment of carriers under the provisions of Class Rate III-A must be reversed.

As justification for its proposition that inconsistent treatment of Texas International and other carriers is lawful, the Board relies on two decisions, NLRB v. Rutter-Rex Mfg. Co., 396 U.S. 258 (1969), and Moog Industries, Inc. v. FTC, 355 U.S. 411 (1958). Both these cases uphold the broad discretion of an administrative agency to fashion the appropriate remedy for a violation of law, and have no applicability whatsoever here. It is particularly inappropriate for the Board to rely on them, in the light of the Board's contention that it has no discretion in the order on review whatsoever (Board Br. 12-15, 29, 31), and is merely applying "even-handedly" an arbitrary formula. See pp. 10-11, supra. In fact, the Board does have a limited discretion in the application of the formula, in its power to control the time of application and to set principles for the allowance of costs. This discretion makes it possible for the Board to treat all local service carriers alike, and it is the Board's failure to do so that is error here. 12/

12/ The Board further cites a set of what it describes as "tax cases" for the proposition that "the mere fact that different results are reached with respect to different persons does not justify the nullification of administrative action" (Board Br. 30).

(Continued)

The point is that the Board's exercise of its discretion cannot be arbitrary and capricious. The cases it cites both show that an agency's exercise of its discretion cannot be arbitrary; indeed, the Supreme Court has specifically said that Moog Industries so provides. FTC v. Universal-Rundle Corp., 387 U.S. 244, 251 (1967). 13/ The Board's discretion here is in fact much more limited than that possessed by the FTC and the NLRB in the law violation cases cited in the Board's Brief, and the Board's arbitrary and inconsistent treatment of Texas International in the proceedings below was not within its discretionary power. These cases offer no support for what the Board did.

VII. CONCLUSION.

For the foregoing reasons, and for the reasons set out in the Brief of Petitioner Texas International Airlines, Inc. submitted

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12/ (Continued)

These cases all involve the valuation of property by local authorities for tax purposes. It is hard to imagine a situation more different from the limited discretion the Board has here much less from the complete lack of discretion it contends it has.

13/ The Board's Brief is incorrect in characterizing NLRB v. Rutter-Rex Mfg. Co., supra, as a case in which the Supreme Court ignored the prejudice of administrative delay. Instead, in Rutter-Rex, the Court assumed for the purpose of decision that the administrative delay was unlawful. The Court found the unlawfulness of the delay irrelevant to the case because it would be unfair to relieve an employer of its back pay obligation to unlawfully discharged employees due to the administrative delay where the price of that relief would be borne by the innocent employees. There is no such question in this case.

October 27, 1970, Order 70-5-108 of the Civil Aeronautics Board should be declared unlawful and set aside insofar as it requires Texas International to refund to the Government $296,792 of the subsidy which Texas International had received for calendar year 1966.

Respectfully submitted,

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